Summer 1991

The Taxpayer's Duty of Consistency

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I. Introduction

A transaction may affect the taxpayer's federal tax liability for both the current period and subsequent periods. No difficulty arises if the taxpayer treats the transaction consistently over the periods. However, significant tax distortions are possible if the taxpayer's characterization of the transaction varies from period to period. A recharacterization may be particularly troublesome if the statute of limitations has expired, and the first period is not open to correction at the time the inconsistent representation is made.

The duty of consistency was developed to address this problem. If the duty applies, the taxpayer is not permitted to shift his position in the subsequent period regardless of whether, as a matter of substantive tax law, the position taken in the prior period was correct.[1] A hallmark of the duty is flexibility. It has been applied to prevent taxpayers from taking inconsistent positions in order to exclude from all tax periods income that clearly is taxable in some period,[2] deduct the same expense in two or more periods,[3] improperly inflate the basis of an asset,[4] convert one type of income into a different, tax-favored type[5] and profit from other sorts of tax abuses.[6]

There have been, however, differences among the courts in their perception of the duty of consistency.[7] As Justice Frankfurter rightly ob-

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1 See, e.g., Cassuto v. Commissioner, 93 T.C. 256, 264 (1989), aff'd in part and rev'd in part as to another issue, 936 F.2d 736 (2d Cir. 1991).

2 E.g., Grayson v. United States, 437 F. Supp. 58, 60 (N.D. Ala. 1977).

3 E.g., Robinson v. Commissioner, 181 F.2d 17, 18 (5th Cir. 1950).

4 E.g., Coldiron v. Commissioner, 54 T.C.M. (CCH) 1084 (1987).

5 E.g., Stoecklin v. Commissioner, 54 T.C.M. (CCH) 452, 459-60 (1987), aff'd per curiam as to other issues, 865 F.2d 1221 (11th Cir. 1989); Akron Dry Goods Co. v. Commissioner, 18 T.C. 1143, 1151-52 (1952), aff'd, 218 F.2d 290 (6th Cir. 1954).

6 E.g., Kielmar v. Commissioner, 884 F.2d 959, 965 (7th Cir. 1989); Herrington v. Commissioner, 854 F.2d 755 (5th Cir. 1988) (applying duty of consistency to prevent taxpayers from removing from income the gain legs of sham straddles when statute of limitations prevented adjustment of the loss legs), cert. denied, 490 U.S. 1065 (1989).

7 See, e.g., Marco v. Commissioner, 25 T.C. 544, 549 (1955); Meurlin v. Commissioner, 25 T.C. 118, 123 (1955).

served, consistency decisions "disclose many views in various degrees of conflict."[8]

This article attempts to clarify this aspect of the procedural tax law. Section II sketches the emergence of the taxpayer duty of consistency,[9] and describes current formulations. The remaining three sections address the major controversies surrounding the duty. Section III asks whether there should be an enforceable taxpayer duty of consistency, and resolves that question in the affirmative. In so doing, it proposes that the justification for the duty of consistency should be grounded in practical policy values fundamental to our tax system rather than the essentially moralistic basis of prior decisions. Section IV describes the proposed elements of the duty of consistency. Section V charts the relationships between the duty of consistency and other anticonsistency doctrines. The final section offers guidelines for determining when the duty of consistency should yield to other devices used to counter inconsistency and when the duty of consistency should preempt the other devices.

II. Emergence and Growth of the Duty of Consistency

The duty of consistency has evolved through hundreds of decisions over more than 60 years.[10] At its core, the doctrine reflects distaste for a taxpayer's attempt to have his cake after already having eaten it. The taxpayer, it is felt, should not be permitted to reduce his tax bill by reporting that one thing is true, and then, after expiration of the statute of limitations, recanting and taking a different position on a later return. The engine that drives the consistency doctrine is the sensibility that truth should not change with the calendar.

A number of early decisions denied taxpayer claims based on inconsistent representations without particular elaboration, apparently, on

[8] Ross v. Commissioner, 169 F.2d 483, 495 (1st Cir. 1948). A contemporary commentator has observed that the duty of consistency is a "developing doctrine." Robert T. Smith, Substance and Form: A Taxpayer's Right to Assert the Priority of Substance, 44 Tax Law. 137, 144 (1990).

[9] The government also may have a duty of consistency in tax cases. This question is explored in Lawrence Zelenak, Should Courts Require the Internal Revenue Service to be Consistent?, 40 Tax L. Rev. 411 (1985).

[10] Not all of this litigation has proceeded under the rubric of duty of consistency. The principle often is called "quasi-estoppel." See, e.g., LX Cattle Co. v. United States, 79-1 U.S.T.C. ¶ 9282, at 86,616 (N.D. Tex. 1979). Unfortunately, the term quasi-estoppel sometimes also is used to refer to equitable estoppel. See, e.g., Theodore S. Lynn & Mervyn S. Gerson, Quasi-Estoppel and Abuse of Discretion as Applied Against the United States in Federal Tax Controversies, 19 Tax L. Rev. 487 (1964). To add another layer of confusion, what is in substance the duty of consistency sometimes is called "estoppel" (e.g., Joyce v. Gentsch, 141 F.2d 891, 896-97 (6th Cir. 1944)), or "election" (e.g., Georgia Properties Co. v. Henslee, 138 F. Supp. 587, 590 (M.D. Tenn. 1955)), despite the fact that equitable estoppel and the doctrine of election are recognized rules distinct from the duty of consistency.

grounds of equity.[11] Other decisions attempted to effect the desired result through a variety of legal and equitable doctrines, such as election, waiver, equitable estoppel, contract principles, refund equities and precepts of statutory construction.[12]

Because of individual doctrinal limitations, however, none of these approaches was fully satisfactory, and the duty of consistency arose to fill the void. Although prefigured by earlier decisions,[13] the taxpayer duty of consistency was established principally by the Supreme Court's decision in *R.H. Stearns Co. v. United States*[14] and the Fifth Circuit's decision in *Alamo National Bank v. Commissioner.*[15]

Those early decisions did not end controversy as to the duty. Although the nuances in the post-*Stearns* cases are numerous, the decisions distill into five principal analytical patterns: (1) cases explicitly or implicitly rejecting any duty of consistency whatsoever, (2) cases upholding a duty only when most or all of the elements familiar to equitable estoppel are present, (3) cases recognizing an expansive consistency duty liberated from the equitable estoppel elements, (4) cases adopting a triune standard somewhere between the second and third patterns and (5) cases treating the duty of consistency as an adjunct to the tax benefit rule.

A. Cases Rejecting Any Consistency Duty

A few courts have rejected application of a duty of consistency in conclusory fashion, without explaining their rationale.[16] Where reasons have been given, two have predominated: (1) The duty of consistency is an impermissible attempt by the Commissioner to circumvent the statute of limitations by recovering, in an open tax period, a deficiency that should have been collected with respect to an earlier period now closed to assessment[17]; and (2) application of the duty would distort the taxpayer's true tax liability.[18]

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[11] See, e.g., Magee v. United States, 282 U.S. 432, 434 (1931); Mahoning Inv. Co. v. United States, 3 F. Supp. 622, 629 (Ct. Cl. 1933).

[12] See, e.g., Grubb v. United States, 38-1 U.S.T.C. ¶ 9151, at 9571-72 (S.D. Cal. 1936); Naumkeag Steam Cotton Co. v. United States, 2 F. Supp. 126, 133-36 (Ct. Cl. 1933); Ralston Purina Co. v. United States, 58 F.2d 1065, 1067-68 (Ct. Cl. 1932).

[13] Although the pedigree blurs, Southern Pac. Co. v. Commissioner, 21 B.T.A. 990 (1930), was perhaps the first trial court opinion identifiably imposing a duty of consistency, and Commissioner v. Liberty Bank & Trust Co., 59 F.2d 320 (6th Cir. 1932), and Haag v. Commissioner, 59 F.2d 514 (7th Cir. 1932), were perhaps the first such opinions by appellate courts.

[14] 291 U.S. 54 (1934).

[15] 95 F.2d 622 (5th Cir.), cert. denied, 304 U.S. 577 (1938).

[16] See, e.g., Marco v. Commissioner, 25 T.C. 544, 549 (1955).

[17] See, e.g., Crosley Corp. v. United States, 229 F.2d 376, 380 (6th Cir. 1956); Commissioner v. Mnookin's Estate, 184 F.2d 89, 92-93 (8th Cir. 1950).

[18] See, e.g., Commissioner v. Union Pac. R.R., 86 F.2d 637, 640 (2d Cir. 1936); Kenosha Auto Transp. Corp. v. Commissioner, 28 T.C. 421, 425 (1957).

Cases stressing such considerations—and thus explicitly or implicitly rejecting a taxpayer duty of consistency—have not been prominent since the early 1970's.[19] However, the matter is not entirely settled. First, in some circuits there have been so few duty of consistency opinions, and these were issued so long ago, that the circuit law is unclear.[20]

Second, there is at least one circuit, the Second Circuit, in which precedents arguably favor an anticonsistency rule, at least in deficiency actions. Initially well disposed to the duty,[21] the Second Circuit developed into the circuit most hostile to it. The Second Circuit's opinions freely mixed two strands of reasoning: (1) that certain elements of equitable estoppel were absent[22] and (2) that imposition of a duty of consistency would traduce the statute of limitations and the annual method of accounting for income taxes.[23] While the first strand implies that a consistency obligation properly may be imposed under some circumstances, the second, taken to its logical conclusion, would bar a consistency obligation under any circumstances, at least in deficiency actions.[24]

Third, very aggressive taxpayers might attempt to contest the legitimacy of a duty of consistency even in other circuits. This is because the Supreme Court has never ruled on the issue unequivocally. The *Stearns*

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[19] See B.C. Cook & Sons, Inc. v. Commissioner, 59 T.C. 516, 521 (1972).

[20] The District of Columbia Circuit is the clearest case in point. See Louis Werner Saw Mill Co. v. Helvering, 96 F.2d 539 (D.C. Cir. 1938); Newaygo Portland Cement Co. v. Helvering, 77 F.2d 536 (D.C. Cir. 1935). The Fourth Circuit also may fall into this class. Fourth Circuit law can be cited for any of three views concerning the duty of consistency: (1) The duty intrinsically is impermissible as contravening the statute of limitations (Clifton Mfg. Co. v. Commissioner, 137 F.2d 290, 293 (4th Cir. 1943)); (2) the duty is operative only if the elements familiar to equitable estoppel exist (Hull v. Commissioner, 87 F.2d 260, 262 (4th Cir. 1937)); and (3) the duty is operative whether or not such elements are present (Interlochen Co. v. Commissioner, 232 F.2d 873, 877-78 (4th Cir. 1956)). Since *Interlochen* did not discuss *Clifton*, there may be room for a Fourth Circuit taxpayer to attack the very notion of a consistency duty.

[21] See Askin & Marine Co. v. Commissioner, 66 F.2d 776, 778 (2d Cir. 1933).

[22] E.g., Helvering v. Brooklyn City R.R., 72 F.2d 274, 275-76 (2d Cir. 1934).

[23] See, e.g., McCullough v. Commissioner, 153 F.2d 345, 347 (2d Cir. 1946); Salvage v. Commissioner, 76 F.2d 112, 114 (2d Cir. 1935), aff'd, 297 U.S. 106 (1936).

[24] The Second Circuit repeatedly has emphasized, however, that different considerations apply in refund actions because they are intrinsically equitable. See, e.g., United States v. Drescher, 179 F.2d 863, 866-67 (2d Cir. 1950); Helvering v. Schine Chain Theatres, 121 F.2d 948, 950 (2d Cir. 1941).

decision[25] is susceptible to divergent interpretations,[26] and subsequent Supreme Court pronouncements have not formed a cohesive pattern.[27]

B. *Cases Limiting the Consistency Duty by Equitable Estoppel Elements*

In *Stearns,* the Supreme Court stated that the rule of preclusion it was applying "has its roots in a principle more nearly ultimate than . . . estoppel."[28] While one might infer from this statement that the duty of consistency should be based on independent criteria and not limited by the technical elements of estoppel, numerous subsequent decisions have hinged the consistency duty on whether various elements of equitable estoppel were present in the case. This conflation of the doctrines was not always fatal. In many cases, the government was able to satisfy the burden imposed.[29] More commonly, however, the claimed preclusion failed due to the absence of one or more of the equitable estoppel elements.[30]

There is little doubt that, at least until the articulation of the triune standard discussed below,[31] the dominant view incorporated the equitable estoppel elements into the duty of consistency. The Tax Court and a plurality of the federal circuit courts tended to this view.[32] Moreover, because there is no intrinsic incompatibility between the incorporationist

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25 R.H. Stearns Co. v. United States, 291 U.S. 54 (1934).

26 See American Light & Traction Co. v. Commissioner, 42 B.T.A. 1121, 1123 (1940) ("[B]ecause the unnamed rule [of *Stearns*] is stated in such general terms, there is extreme difficulty in knowing whether or not to apply it in particular cases."), aff'd, 125 F.2d 365 (7th Cir. 1942). Reflecting such confusion, a number of later decisions interpreted *Stearns* as an equitable estoppel case. E.g., Brewerton v. United States, 9 F. Supp. 503, 508 (Ct. Cl. 1935); Barbados #7, Ltd. v. Commissioner, 92 T.C. 804, 813 (1989).

27 See, e.g., McEachern v. Rose, 302 U.S. 56, 59-63 (1937), rev'g 86 F.2d 231 (5th Cir. 1936); Helvering v. Salvage, 297 U.S. 106, 109 (1936), aff'g & remanding 76 F.2d 112 (2d Cir. 1935) (both appearing to disapprove of the consistency doctrine, but not formally rejecting it).

28 *Stearns,* 291 U.S. at 61-62.

29 See, e.g., Building Syndicate Co. v. United States, 292 F.2d 623, 626 (9th Cir. 1961); Brown v. United States, 292 F. Supp. 527, 532 (D. Or. 1968); Bartel v. Commissioner, 54 T.C. 25, 32 (1970).

30 See, e.g., Studebaker-Packard Corp. v. United States, 61-2 U.S.T.C. ¶ 9551, at 81,312 (N.D. Ind. 1961); Deviney Constr. Co. v. Commissioner, 36 T.C.M. (CCH) 413, 415 (1977); Hunt v. Commissioner, 27 T.C.M. (CCH) 791, 797-98 (1968).

31 See Section II.D.

32 See e.g., Manhattan Bldg. Co. v. Commissioner, 27 T.C. 1032, 1042-43 (1957); Crosley Corp. v. United States, 229 F.2d 376, 380-81 (6th Cir. 1956); Commissioner v. Mellon, 184 F.2d 157, 159-60 (3d Cir. 1950); Northwestern States Portland Cement Co. v. Huston, 126 F.2d 196, 200-01 (8th Cir. 1942); Commissioner v. Saltonstall, 124 F.2d 110, 112-13 (1st Cir. 1941); Hawke v. Commissioner, 109 F.2d 946, 949, (9th Cir.), cert. denied, 311 U.S. 657 (1940); Lofquist Realty Co. v. Commissioner, 102 F.2d 196, 200-01 (8th Cir. 1939).

view and the triune standard,[33] it is fair to say that the former remains the majority view today.

C. *Cases Supporting an Expansive Consistency Duty*

In contrast to the cases superimposing equitable estoppel elements onto the duty of consistency, many other decisions have held that the consistency rule does not require the presence of all the technical elements of estoppel.[34] Consideration of this counterview is complicated by two facts, however. First, if not all technical elements are required, the question becomes: Which elements are dispensable? No court adopting the expansive view has discussed that question in a comprehensive fashion. Second, precedents often conflict even within the same circuit, rendering it difficult to state with confidence whether these circuits espouse or reject the incorporation of equitable estoppel elements into the duty of consistency.[35]

D. *Cases Adopting the Triune Standard*

In *McMillan v. United States*,[36] a federal district court distilled the teaching of prior cases into the first comprehensive statement of the elements of the duty of consistency. The court found there were three elements: (1) The taxpayer made a representation of fact or reported an item for tax purposes in one tax year; (2) the Service acquiesced in or relied on that fact for that year; and (3) the taxpayer desires to change the representation, previously made, in a later tax year after the first year has been closed by the statute of limitations.[37]

[33] See text accompanying note 42.

[34] E.g., Arkansas Best Corp. v. Commissioner, 83 T.C. 640, 659 (1984), aff'd in part & rev'd in part as to other issues, 800 F.2d 215 (8th Cir. 1986), aff'd, 485 U.S. 212 (1988). The former United States Court of Claims viewed the duty of consistency expansively. See, e.g., Hess v. United States, 537 F.2d 457, 462-64 (Ct. Cl. 1976). The appellate jurisdiction of the former Court of Claims is now vested in the United States Circuit Court for the Federal Circuit. 28 U.S.C. § 1295 (1988).

[35] For example, the Tenth Circuit has vacillated in this regard. Compare Continental Oil Co. v. Jones, 177 F.2d 508, 512 (10th Cir. 1949) with Doneghy v. Alexander, 118 F.2d 521, 524 (10th Cir.), cert. denied, 314 U.S. 621 (1941).

The Fifth Circuit has authored the greatest number of opinions taking an expansive view of the duty of consistency. However, even in that court, echoes of the equitable estoppel elements have been heard. Compare Orange Sec. Corp. v. Commissioner, 131 F.2d 662, 663 (5th Cir. 1942) (rejecting the equitable estoppel distinction that only misstatement of fact will support preclusion and that mistake of law will not) with Herrington v. Commissioner, 854 F.2d 755, 758 (5th Cir. 1988), cert. denied, 490 U.S. 1065 (1989) and Commissioner v. Dallas Title & Guar. Co., 119 F.2d 211, 215 (5th Cir. 1941) (both accepting that distinction). The Eleventh Circuit, formed out of the old Fifth Circuit in 1981, follows the latter's position as to the duty of consistency. See Shook v. United States, 713 F.2d 662, 666-67 (11th Cir. 1983).

[36] 64-2 U.S.T.C. ¶ 9720 (S.D.W. Va. 1964).

[37] Id. at 93,838.

A decade later, in *Beltzer v. United States*,[38] the Eighth Circuit adopted the *McMillan* formulation virtually without change. Bearing the imprimatur of a circuit court, the triune standard made substantial headway. No court has overtly rejected it, and many have adopted it.[39]

Nevertheless, uncertainty persists. At first, one might think that the three enumerated elements express the entire consistency doctrine, that they are the only elements that need to be taken into account under this formulation. The *Beltzer* district court adopted this view, for it described the three elements as the "sole" requirements for application of the consistency duty.[40] Most courts, however, do not agree. They have freely added elements to the consistency analysis.[41]

In reality, the triune standard is not independent of the estoppel-elements-incorporation view and the expansive view. The easy acceptance the formulation has enjoyed is attributable to the fact that it is equally capable of adoption by an incorporationist court or an expansive court.[42] Widespread acceptance of the triune standard creates a false perception of harmony. The tension between the incorporationist view and the expansive view continues on a less obvious level.

E. Cases Treating the Consistency Duty as an Adjunct to the Tax Benefit Rule

Generally, the tax benefit rule provides that, when a taxpayer receives a tax benefit from a deduction in one year and recovers the amount in a later year, she must include that recovery in income for the later year.[43] The Tax Court and some other courts recognize an "erroneous deduction exception" under which the tax benefit rule applies only if the deduction was legally proper in the year taken.[44] In 1971, in *Mayfair Minerals*, the Tax Court established the duty of consistency as an exception to the erro-

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[38] 495 F.2d 211 (8th Cir. 1974), aff'g 73-2 U.S.T.C. ¶ 9512 (D. Neb. 1973).

[39] E.g., Kielmar v. Commissioner, 884 F.2d 959, 965 (7th Cir. 1989); *Herrington*, 854 F.2d at 758; Hess v. United States, 537 F.2d 457, 463 (Ct. Cl. 1976); Johnston v. United States, 605 F. Supp. 26, 28 (D. Mont. 1984); Unvert v. Commissioner, 72 T.C. 807, 815 (1979), aff'd on other grounds, 656 F.2d 483 (9th Cir. 1981), cert. denied, 456 U.S. 961 (1982).

[40] *Beltzer*, 73-2 U.S.T.C. ¶ 9512, at 81,620-21.

[41] E.g., Shook v. United States, 713 F.2d 662, 667 (11th Cir. 1983); Garner v. Commissioner, 42 T.C.M. (CCH) 1181, 1187 (1981).

[42] For example, *Beltzer* and *McMillan*, the original cases, seemed to differ as to the role of the equitable estoppel factors, the *Beltzer* court seeming to take an incorporationist view, *Beltzer*, 495 F.2d at 213, while *McMillan* evinced an expansive spirit, McMillan v. United States, 64-2 U.S.T.C. ¶ 9720, at 93,838-39 (1964).

[43] IRC § 111; e.g., Dobson v. Commissioner, 320 U.S. 489, 503 (1943).

[44] E.g., Twitchco, Inc. v. United States, 348 F. Supp. 330, 335 (M.D. Ala. 1972); Kingsbury v. Commissioner, 65 T.C. 1068, 1087-88 (1976). But see, e.g., Unvert v. Commissioner, 656 F.2d 483, 486 (9th Cir. 1981), cert. denied, 456 U.S. 961 (1982).

neous deduction exception.[45] When the elements of the duty of consistency are present, the Tax Court has required the inclusion of the recovery item in income under the tax benefit rule even though the original deduction was clearly improper.

This variant has greater significance for the tax benefit rule than for the duty of consistency. The variant neither addresses the circumstances that must be present to trigger application of the consistency duty, nor enlarges or contracts the reach of the duty. Certainly, *Mayfair Minerals* and similar decisions do not state that the Tax Court views the consistency doctrine as operating exclusively in the context of erroneous deductions under the tax benefit rule.[46] Accordingly, this view of the duty of consistency is interesting, not so much because of its effect on the duty per se, but rather because it raises the question of the proper relationship of the duty to other doctrines used to promote overall coherence in the tax treatment of transactions with multi-year effects.

In summary, the taxpayer duty of consistency, an alloy of many different items, some legal and some equitable in nature, has emerged as a rule of procedural tax law independent of its forerunners. In the decades since its debut, five main views interpreting the duty have been propounded. These views pose three policy questions: (1) Should such a duty be required of taxpayers in any form? (2) If so, what are the appropriate contours of the duty? (3) What should be the relationship of the duty to other means of enforcing consistent tax reporting? These questions are answered in the following sections.

III. Desirability of Requiring Some Duty of Consistency

This article argues that a taxpayer duty of consistency promotes substantial policy values and is a valuable component of our tax system. Specifically, the duty of consistency (1) buttresses the self-reporting system, (2) fosters finality and repose and (3) facilitates the determination of correct tax liability.

Preliminarily, it should be noted that in emphasizing these policy values this article attempts to put the duty of consistency on a new basis. As previously noted, the duty of consistency originally was driven principally by a moral consideration: the perception that taxpayers taking inconsistent positions obtain unfair advantage. While that sentiment is entirely understandable, lashing the duty of consistency to mainly moral moorings creates substantial difficulties. Accordingly, the following analysis rests the duty on a foundation of practical policy values impor-

[45] Mayfair Minerals, Inc. v. Commissioner, 56 T.C. 82, aff'd per curiam, 456 F.2d 622 (5th Cir. 1972); see also Southern Pac. Transp. Co. v. Commissioner, 75 T.C. 497, 558-61 (1980).

[46] See e.g., Stoecklin v. Commissioner, 54 T.C.M. (CCH) 452, 459-60 (1987) (double deduction); Church v. Commissioner, 37 T.C.M. (CCH) 1236, 1240 (1978) (basis of property).

tant to the tax system. Ultimately, this is a more satisfactory basis than the moralistic impulses animating the prior consistency cases.

A. Contribution to the Self-Reporting System

Self-reporting is the bedrock of our system of taxation[47] as revenue statistics amply demonstrate.[48] Since the tax revenues collected by the government overwhelmingly are the amounts reported by taxpayers on their returns, maintaining and strengthening accurate self-reporting must be of central concern.

The presence of a consistency obligation buttresses accurate self-reporting in two ways. First, it reduces the temptation to engage in calculated inconsistency and manipulation of the statute of limitations. A taxpayer who realizes that he cannot benefit from his inconsistency has a diminished incentive to "fudge." This buttresses self-reporting by discouraging disingenuous reporting.

Second, a consistency obligation bolsters confidence in the fairness of the system. Public suspicion that honest taxpayers are "suckers," that is, shouldering their fair share of the cost of operating the nation's government, while other taxpayers escape properly owed taxes by manipulating the system, is potentially devastating to self-reporting.[49] The addition of §§ 56(f) and (g) in 1986 provides a parallel.[50] Previously, burgeoning profitability of corporations reflected in their shareholder reports contrasted sharply with the apparent penury suggested by their tax returns. This spectacle bred public cynicism about the accuracy of corporate returns and public suspicion that corporations were avoiding taxes. Section 56 was amended to reduce the inconsistency between financial and tax reporting, thus fortifying public confidence in the fairness of the system.[51] The duty of consistency addresses game-playing between returns much as amended § 56 addresses game-playing between returns and shareholder reports.

Thus, preventing taxpayers from reaping tax advantage by shifting characterizations of transactions, the consistency doctrine can help both

[47] See, e.g., United States v. Rodgers, 461 U.S. 677, 683 (1983); Flora v. United States, 362 U.S. 145, 176 (1960); Helvering v. Mitchell, 303 U.S. 391, 399 (1938); 26 C.F.R. § 601.103(a) (1991).

[48] "In 1990, taxpayers filed more than 200 million tax returns and paid over $1 trillion. IRS enforcement efforts added another $51 billion. The difference between the amounts is a measure of voluntary compliance." Internal Revenue Service, U.S. Dep't of Treasury, Internal Revenue Service Highlights 1980, at 5 (1991).

[49] Curbing such suspicion and restoring public confidence in the tax system were important objectives of the historic tax reforms of 1986. See, e.g., The President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity 1, 2 (1985).

[50] Tax Reform Act of 1986, Pub. L. 99-514, § 701(a), 100 Stat. 2085, 2326-33.

[51] See Staff of the Joint Comm. on Tax'n, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986, at 433, 434-35 (Comm. Print 1987).

to deter individual abuse of self-reporting and to preserve the public confidence essential to the self-reporting system.

B. *Contribution to Finality and Repose*

A value long embedded in our legal system is that, at some point, parties should be confident that the legal consequences of a transaction are fixed. Statutes of limitations embody this value. Each such statute states the point in time at which the legislature believes the benefits of finality and repose outweigh the benefit of correcting possibly erroneous characterizations of transactions.

As noted in the previous section, one of the principal objections interposed by courts rejecting any taxpayer consistency duty has been that the duty would traduce the statute of limitations on assessment of tax underpayments.[52] These courts reason that it is the Service's responsibility to root out taxpayer errors within the limitations period. If the Service fails to do so, it should not be permitted to recoup the loss by alleging taxpayer inconsistency. To do so, according to these courts, would be, in effect, to collect the earlier, barred taxes in the later, open tax period, making an end run around the statute of limitations.[53]

The objection is unsound, however. The consistency doctrine merely allows facts deemed to have been established in a closed tax period to be used in determining tax liability in an open tax period. There is no violation of the statute of limitations because the assessment is made only with respect to the open period.[54]

More fundamentally, the duty of consistency actually promotes, rather than derogates, the values of finality and repose expressed in the statute of limitations. It is the opponent of the consistency rule, not its proponent, who seeks to disturb the finality of the prior transactions. In insisting on consistency, the government argues for taking the prior period returns at face value and treating the characterizations on those returns as final. In demanding liberty from his prior returns, the inconsistent taxpayer is the party exhuming characterizations and representations that otherwise would have been at rest.[55]

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[52] See IRC § 6501 (current statute of limitations on assessments).

[53] E.g., Ross v. Commissioner, 169 F.2d 483, 494 (1st Cir. 1948); Kenosha Auto Transp. Corp. v. Commissioner, 28 T.C. 421, 425 (1957).

[54] See, e.g., Herrington v. Commissioner, 854 F.2d 755, 757 (5th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); Wentworth v. Commissioner, 25 T.C. 1210, 1213 (1956), aff'd, 244 F.2d 874 (9th Cir. 1957).

[55] See, e.g., McMillan v. United States, 64-2 U.S.T.C. ¶ 9720, at 93,839 (S.D.W. Va. 1964) (absent duty of consistency "there would be no finality to the tax determinations" in many cases); Mayfair Minerals, Inc. v. Commissioner, 56 T.C. 82, 86 (1971), aff'd per curiam, 456 F.2d 622 (5th Cir. 1972).

C. Contribution to Determination of Correct Tax Liability

To correctly determine a taxpayer's deficiency or overpayment, a court first must select an appropriate rule of liability, and then must accurately ascertain the facts of the particular case so as to apply the rule. Therefore, in determining the extent of the duty of consistency, alternatives should be evaluated in part as to whether they yield sound rules of liability and whether they advance or impede accuracy in factfinding. As shown below, a tax system which requires some duty of consistency is superior in both of these respects to one that does not.

An important theoretical question lurks in the apparently straightforward observation that correct tax liability should be determined: Is the paradigm of correctness based only on the open tax year, or is it based on the transaction taken as a whole including all of its multi-year effects?

If the first basis is preferable, it is inappropriate to impose a duty of consistency. As a general matter, tax liabilities are determined on an annual or other periodic basis, and each period is a separate taxable period.[56] The duty of consistency precludes the taxpayer from shifting his position with respect to a transaction with multi-year effects even if that position is factually or legally incorrect. It thus can project the error of the closed year into the open year, potentially rendering inaccurate the tax liability determined by the court for the subsequent year. For this reason, a number of decisions rejected the duty of consistency as incompatible with the policy of periodic determination of tax liability.[57]

The counter argument, however, is more persuasive. We employ periodic reporting because of ease of administration, not because it is the only correct way to tabulate tax accounts. The periodic reporting system is not sacrosanct, and it often yields to exigent circumstances.[58] The anti-consistency view achieves correctness as to the open year at the expense of great inaccuracy with regard to the whole transaction. The taxpayer who improperly reduced her tax in the closed period is allowed to retain that benefit in the open period with the result that the government receives less revenue than Congress intended.

In contrast, the consistency rule, by holding the taxpayer to her original position, allows the government to recover in the open period at least part of the revenue it was deprived of in the closed period.[59] In this case,

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[56] E.g., Commissioner v. Sunnen, 333 U.S. 591, 598 (1948).

[57] See, e.g., Commissioner v. Mnookin's Estate, 184 F.2d 89, 92 (8th Cir. 1950); Countway v. Commissioner, 127 F.2d 69, 76 (1st Cir. 1942).

[58] IRC §§ 111, 172, 381-384, 481, 1212, 1311-1314 and 1341 all are modifications of the annual reporting system in the income tax area, as were the income averaging rules of former §§ 1301-1305.

[59] The correction is not exact. Because of a variety of factors—including tax rate, tax bracket differentials and time value of money considerations—rarely will the economic value of the amount recovered in the open year equal the economic value of the amount underpaid in

two wrongs do make a right—or, at least, two partially offsetting wrongs (pro-taxpayer error in the closed period and pro-government error in the open period) come closer to the overall correct incidence of tax than do one wrong and one right.[60] An approximation of the tax consequences of the transaction as a whole is preferable to verisimilitude of tax consequences as to only the open half of the transaction.[61] Thus, the rough transactional accuracy fostered by a duty of consistency is a better liability principle than the tunnel vision insistence on periodic reporting which marks the anti-consistency view.

The anti-consistency view also is vulnerable with regard to the factfinding it requires. Because the duty of consistency binds a taxpayer to his prior representation regardless of its correctness as a matter of substantive tax law, a pro-consistency court need not determine the accuracy of the taxpayer's prior representation. Since an anti-consistency court will not hold the taxpayer to her prior representation, it must receive and evaluate evidence as to whether the original characterization was correct in order to reach a determination as to the open year. For example, if the Service asserts that an item was includable in the taxpayer's income for 1991 and the taxpayer rejoins that it actually was includable in his income for 1981 (even though he did not report it on his 1981 return), the anti-consistency court will have to consider evidence to determine whether 1981 was the proper year for inclusion.

This creates a practical factfinding problem. What if the factual record for 1981 is incomplete or unreliable? The closed and open years often are separated by a decade or more,[62] and during that interval documents can be lost, memories can fade and witnesses can die or disappear. The anti-consistency rule might require the court to decide the question based on stale and incomplete evidence.[63] Because a reliable decision requires an accurate record, the ability of an anti-consistency court to achieve accuracy even as to the open year is likely to be limited as a practical matter.

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the closed year. See, e.g., Bennet v. Helvering, 137 F.2d 537, 538 (2d Cir. 1943). Nonetheless, from a revenue standpoint, imperfect correction is preferable to no correction at all.

[60] See Louis A. Del Cotto & Kenneth F. Joyce, Double Benefits and Transactional Consistency Under the Tax Benefit Rule, 39 Tax L. Rev. 473, 476-77 (1984), for examples of how double tax savings, if uncorrected, distort a taxpayer's true economic gain.

[61] See, e.g., Orange Sec. Corp. v. Commissioner, 131 F.2d 662, 663 (5th Cir. 1942); Buras v. Commissioner, 36 T.C.M. (CCH) 1311, 1314 (1977). The policy preference argued for here also has been recognized in the context of the tax benefit rule. See, e.g., Hillsboro Nat'l Bank v. Commissioner, 460 U.S. 370, 383 (1983); Estate of Munter v. Commissioner, 63 T.C. 663, 678 (1975) (Tannenwald, J., concurring).

[62] See, e.g., Building Syndicate Co. v. United States, 292 F.2d 623 (9th Cir. 1961) (1927 and 1943); Tennessee Prods. Corp. v. United States, 107 F. Supp. 578 (Ct. Cl. 1952) (1917 and 1939 through 1941); Cleveland-Sandusky Brewing Corp. v. Commissioner, 30 T.C. 539 (1958) (1918 and 1950).

[63] E.g., Bartel v. Commissioner, 54 T.C. 25, 32 (1970).

In summary, the duty of consistency contributes directly to several major policy goals: It bolsters the self-reporting system; it protects finality and repose; and it facilitates the determination of correct tax liability both by providing a superior liability principle and by minimizing factfinding inaccuracies. Accordingly, the threshold question—"Should a duty of consistency be required of taxpayers?"—should be answered in the affirmative.

IV. Appropriate Contours of the Duty of Consistency

This section advances a detailed reformulation of the taxpayer duty of consistency. Heuristically, it is profitable to compare the elements of this reformulation with those of the *McMillan/Beltzer* version of the duty since that version has been widely adopted, at least nominally.[64] While some aspects of the *McMillan/Beltzer* approach are valuable, substantial doctrinal departures and clarifications are required.

Under *McMillan/Beltzer*, the duty of consistency prevents a taxpayer from shifting position if the following three elements exist:

(1) The taxpayer has made a representation of fact or reported an item for tax purposes in one tax year;
(2) The Service has acquiesced in or relied on that fact for that year;
(3) The taxpayer desires to change the representation, previously made, in a later tax year after the first year has been closed by the statute of limitations.[65]

To ease the transition from this familiar version, the reformulation borrows the triune format, mingling familiar and new elements. Specifically, this article advocates that the duty of consistency should prevent a taxpayer from shifting position if the following three elements exist:

(1) The taxpayer or a sufficiently related person made a written representation to the Service regarding an item in one tax period;
(2) The taxpayer desires to change the representation, previously made, at a time when correction of the previous representation effectively would be prevented by the statute of limitations;
(3) The taxpayer fails to establish the existence of any specified affirmative defense to the duty of consistency.

[64] See text accompanying notes 36-42.
[65] McMillan v. United States, 64-2 U.S.T.C. ¶ 9720, at 93,838 (S.D.W. Va. 1964); see also Beltzer v. United States, 495 F.2d 211, 212 (8th Cir. 1974).

The advantages of the reformulation over the old standard are evaluated below on an element-by-element basis.

A. Taxpayer's Representation

The reformulation of the first element substitutes "in one tax period" for *McMillan/Beltzer*'s "in one tax year" to clarify that the duty of consistency also applies to taxes calculated on other than an annual basis. In addition, there are four other differences which require fuller explication. They relate to: (1) consistency privity, i.e., when the taxpayer should be bound by a prior representation made by a person related to him; (2) the types of prior representations to which a taxpayer should be bound; (3) the requirement that the representation be written; and (4) the requirement that the representation be made to the Service.

1. Consistency Privity

Although the triune standard and other consistency cases state that the taxpayer is bound by her prior representations, there is a broader preclusive effect. In practice, "prior representation of the taxpayer" has been understood to mean "prior representation of the taxpayer or a sufficiently related person." The reformulation makes that understanding explicit.

Moreover, the proposal strives for greater coherence than that thus far exhibited by the consistency case law dealing with related party representations. The disarray in this area stems in part from a line of cases interpreting an opinion of the Court of Claims. In *Ford v. United States*,[66] the court refused to require beneficiaries to use as their basis in inherited stock the value used by the executor on the estate tax return. The decedent and the beneficiaries—his minor children—lived in Brazil. In rejecting the Service's position, the court referred to the children's age, as well as to their lack of knowledge.[67]

It is hard to derive a general principle from *Ford*. Reading the case broadly, post-*Ford* taxpayers argued that a taxpayer could not be bound by a prior representation unless he had participated personally in making that representation. That proposition met with varying judicial reactions. Four years after *Ford*, the *McMillan* court was patently unimpressed by the broad reading of *Ford* or even by *Ford* itself, suggesting that it be limited to its facts.[68] Other cases, although distinguishing *Ford*,

[66] 276 F.2d 17 (Ct. Cl. 1960).

[67] Id. at 22 ("In the instant case, the plaintiffs were, respectively, 15 and 12 years of age at the time of their father's death. They resided in Brazil and of course had no knowledge of what was being written in their father's estate tax return in the United States.").

[68] *McMillan*, 64-2 U.S.T.C. at 93,839.

implied that the case, as well as the broad "nonparticipation" interpretation of it, might have validity.[69]

Sixteen years after *Ford*, however, the Court of Claims limited its own precedent. *Hess v. United States*[70] involved the same core question: Does the basis of stock for income tax purposes have to be limited to the fair market value of that stock as reported on an estate tax return? The court held that under the duty of consistency the beneficiaries were required to use the estate tax value because the interests of the beneficiaries and the estate were "very closely related."[71] The court acknowledged *Ford*, but ignored the facts that the *Hess* beneficiaries were also minors at the time of the estate tax representation and were not personally involved in it.[72] Although *Hess* therefore seems to have overruled *Ford* de facto, it remains to be seen whether *Ford* will survive as an influence on courts.

These cases and others[73] send mixed signals as to the dimensions of consistency privity. The value of predictability would be served by defining "sufficiently related person" with greater clarity. Two polar approaches—the flexible and the formal—are available. The greatest flexibility would result if the court applied the duty of consistency whenever substantial operational interaction or commonality of economic interest exists between the taxpayer and the other person. *Hess* took this approach in its statement that the taxpayers and the trusts were "very closely related."[74] A comparable level of generality operates under § 482, which allows the Service to reallocate tax attributes between entities which are "owned or controlled directly or indirectly by the same interests."[75] However, *Ford* and its successors inspire caution. Granting so general a mandate to the courts inevitably would produce many irreconcilable decisions.

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[69] See, e.g., *Beltzer*, 495 F.2d at 213; Griffith v. United States, 71-1 U.S.T.C. ¶ 9280, at 86,085 (N.D. Tex. 1971).

[70] 537 F.2d 457 (Ct. Cl. 1976).

[71] Id. at 464.

[72] As the dissent noted, the majority gave "only lip service" to *Ford*. Id. at 465 (Kunzig, J., dissenting).

[73] For example, many decisions have held that a transferee is bound by prior representations made by his transferor. E.g., Interlochen Co. v. Commissioner, 232 F.2d 873, 877 (4th Cir. 1956); Portland Oil Co. v. Commissioner, 109 F.2d 479, 486 (1st Cir.), cert. denied, 310 U.S. 650 (1940). But see Fahs v. Florida Mach. & Foundry Co., 168 F.2d 957, 959 (5th Cir. 1948).

Other cases in the area of consistency privity include Hancock Bank v. United States, 254 F. Supp. 206, 208 (S.D. Miss. 1966) (estate bound by representations of its decedent), aff'd on other grounds, 400 F.2d 975 (5th Cir. 1968); Spruance v. Commissioner, 60 T.C. 141, 156 (1973) (representations made by a person acting in a fiduciary capacity do not bind that person when acting in her personal capacity).

[74] *Hess*, 537 F.2d at 464.

[75] This language was intended to be applied flexibly with an eye to the practical realities of control rather than to the formalities of relationships. See, e.g., B. Foreman Co. v. Commissioner, 453 F.2d 1144, 1153 (2d Cir.), cert. denied, 407 U.S. 934 (1972).

This problem would be curbed under a formal approach, that is, one in which "sufficiently close relationships" are specifically and exclusively enumerated. Of course, there is no shortage of similar enumerations under the Code.[76] Unfortunately, none of these enumerations is broad enough to encompass all the relationships that have been found sufficient to trigger consistency adjustments in the reported cases. For example, the § 267(b) relationships omit estates and their decedents, fiduciaries and beneficiaries, which are prominent relationships in consistency case law.[77] In like fashion, the § 1313(c) rules do not extend to any family relationship other than spousal,[78] and they do not relate to estates and trusts when these entities have common beneficiaries.[79]

Since both of the polar approaches are problematic, this article proposes that they be used conjunctively. The taxpayer should be bound to the prior representation of another person whenever there exists between them substantial operational interaction or commonality of economic interests. Without limitation, this test will be held to be met whenever any relationship enumerated in any Code section defining attribution or related party status exists. The second portion of the test obviates the possibility that a court (like the *Ford* court) will disregard the essential identity of interests between the taxpayer and the related party. The first portion serves as a backstop against the unlikely event that a case to which the duty of consistency should be applied will slip through the cracks due to the absence of an enumerated relationship.

2. *Representations to Which Taxpayer Should Be Bound*

In detailing the types of prior representations to which a taxpayer should be bound, the reformulation substitutes "made a representation" for the *McMillan/Beltzer* language "made a representation of fact or reported an item." Three aspects of the substitution are significant. Under the reformulation, (1) the prior representation need not be one "of fact;" (2) the prior representation need not be on a tax return; and (3) under appropriate circumstances, an omission can constitute a representation.

The proposal discards the notion that the duty of consistency operates only if the representation made by the taxpayer or related person as to the closed year was a representation of fact. The "fact versus law" distinction is one of the culpability-based factors borrowed from the doc-

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[76] See, e.g., IRC §§ 52, 267(b), (c), 318, 465(b)(3)(C), 382(l)(3)(A), 503(b), 707(b), 1313(c), 1504(a), 1563(a), (b), (d) & (e), 6901(a)(1); see also Reg. § 301.6402-2(e).

[77] See, e.g., Griffith v. United States, 71-1 U.S.T.C. ¶ 9280 (N.D. Tex. 1971); Church v. Commissioner, 37 T.C.M. (CCH) 1236 (1978).

[78] IRC § 1313(c)(1).

[79] See, e.g., Taylor v. Commissioner, 27 T.C. 361, 370-72 (1956), aff'd on other grounds, 258 F.2d 89 (2d Cir. 1958).

trine of equitable estoppel. As is argued in Section IV.B, those factors in general and the "fact versus law" distinction in particular do more harm than good and should be eliminated.

The proposal also makes clear that representations are not limited to those made on a return. Although preceded by a disjunctive, the "reported an item for tax purposes" language of *McMillan/Beltzer* may give the impression that the duty of consistency operates only with respect to return representations. This is inaccurate. Although the great majority of consistency cases involve representations made on tax returns, not all do. Other representations also have given rise to consistency controversies.[80] The reformulation confirms those cases and the principle that representations not made on a return can be operative for duty of consistency purposes.

The reformulation also clarifies that an omission can be a representation. There are two principal ways a taxpayer can omit an income item from his return for a given year: He could write "zero" on the appropriate lines on the return or he could leave those lines blank. Curiously, to some courts, the taxpayer's choice might make a difference for consistency purposes. A number of decisions have held or implied that an omission cannot constitute a representation for duty of consistency purposes.[81] Under such a rule, the duty of consistency presumably would require an inconsistent taxpayer to include the income in a later year if he wrote "zero" on the appropriate lines on his return, but would not require such inclusion if he simply left those lines blank.

Such divergent results are unsupportable, and the preponderance of the cases hold that an omission can constitute an implied representation which, under the duty of consistency, a taxpayer cannot subsequently repudiate.[82] However, this should be the case only when the taxpayer or related person had an affirmative duty to disclose the item. The obvious example would be a tax return, which is made under oath. This ap-

[80] The most recent example is Griffith v. Commissioner, in which the taxpayer was held to representations in consent forms executed by an unauthorized agent. 56 T.C.M. (CCH) 220, 226 (1988), further proceedings, 56 T.C.M. (CCH) 1263 (1989); see also R.H. Stearns Co. v. United States, 291 U.S. 54 (1934); LX Cattle Co. v. United States, 79-1 U.S.T.C. ¶ 9282 (N.D. Tex. 1979); Erickson v. United States, 309 F.2d 760 (Ct. Cl. 1962); Sabine Royalty Corp. v. Commissioner, 17 T.C. 1071 (1951).

[81] See, e.g., Ross v. Commissioner, 169 F.2d 483, 496 (1st Cir. 1948); Louis Werner Saw Mill Co. v. Helvering, 96 F.2d 539, 543 (D.C. Cir. 1938); Manhattan Bldg. Co. v. Commissioner, 27 T.C. 1032, 1043 (1957).

[82] E.g., Wentworth v. Commissioner, 244 F.2d 874, 875 (9th Cir. 1957); Doneghy v. Alexander, 118 F.2d 521, 524 (10th Cir.), cert. denied, 314 U.S. 621 (1941); Portland Oil Co. v. Commissioner, 109 F.2d 479, 485 (1st Cir.), cert. denied, 310 U.S. 650 (1940).

proach is consonant with a number of reported consistency opinions[83] and is supported by several aspects of the nontax law.[84]

Clifton Manufacturing Co. v. Commissioner[85] illuminates this principle. In that case, although one of the taxpayer's customers was obligated during 1934 to pay interest to the taxpayer, it did not make the payment because it was in serious financial straits. The debtor paid the 1934 debt in 1937. The taxpayer, which was on the accrual method of accounting, did not report the interest as income on its 1934 return, or on any subsequent return. The Service asserted that the interest should be included in 1937 as the prior years were closed under the statute of limitations. The circuit court refused to apply the duty of consistency on the ground that the taxpayer had made no inconsistent representations. Instead, in the court's view, throughout the litigation, the taxpayer maintained only one position: The item was properly accruable in 1934.[86]

Under the standards proposed in this article, the court's decision does not withstand scrutiny. Since an accrual method taxpayer is obligated to report all income accrued during the year on its return for that year, the taxpayer's omission of the interest from its 1934 return was an implied representation that it had not accrued in 1934. When the taxpayer later attempted to defeat the 1937 adjustment by contending that the interest had accrued in 1934, it contradicted its prior implied representation. The court's error in *Clifton Manufacturing* was its failure to realize that an omission can be (and in that case should have been) an actionable representation for duty of consistency purposes.

3. *Requirement that the Representation Be in Writing*

The suggestion that duty of consistency adjustments can be founded on representations other than those on a tax return has potential difficulties. First, is the issue of proof of the prior representation. Human perception and recall being notoriously fallible, how are we to be sure that the prior representation was to the effect now alleged? Second, there is a potential problem as to the seriousness of the prior representation. The

83 E.g., Countway v. Commissioner, 127 F.2d 69, 76 (1st Cir. 1942); Stewart v. United States, 100 F. Supp. 221, 226-27 (D. Neb. 1951). In Commissioner v. Arnold, the taxpayer was a nonresident alien and was not required to file a return. 147 F.2d 23, 26 (1st Cir. 1945). The court held that the taxpayer's failure to report an item was not an omission rising to the level of an implied representation. Id. Since the taxpayer was under no legal duty to speak, the reformulation proposed here would reach the same result.

84 It is hornbook law that omissions as well as commissions can give rise to tort liability and even to criminal liability. This is the case when the defendant was under a legal duty to perform a given act but failed, without adequate defense, to perform it. See, e.g., 21 Am. Jur. 2d Criminal Law § 36 (1981); 74 Am. Jur. 2d Torts § 11 (1974).

85 137 F.2d 290 (4th Cir. 1943), rev'g 1 T.C. 71 (1942).

86 137 F.2d at 293.

rule should not place taxpayers at hazard for every utterance, no matter how casual and ill-considered. The prior representation must be of such a level of gravity that we feel comfortable rendering it immutable.

At least formally, the old triune standard has no safeguard against the above concerns. The reformulation addresses them by requiring that the representation be in writing.[87] A written representation obviously is superior to an oral representation from the standpoint of certainty. Moreover, the taxpayer should be expected to be in a serious state of mind when he submits a written communication to the Service with respect to his tax liabilities.

4. *Requirement that Representation Be Made to the Service*

The taxpayer should not be bound by every written statement the Service obtains regardless of to whom the statement was made. For example, the taxpayer may submit a financial statement to a potential lender which asserts ownership of a given asset and lists its value. If ownership or value were at issue in a later tax controversy and the Service obtained a copy of the financial statement, that statement undoubtedly would be admissible evidence. The duty of consistency, however, should not preclude the taxpayer from offering other evidence on the issue that is contrary to the financial statement.

This result is clearer under the reformulation than it is under the triune standard. In some cases, the Service has argued that the duty of consistency binds the taxpayer to a statement contained in its books and records.[88] *McMillan/Beltzer* requires that the representation be "for tax purposes." Since one important reason a business maintains books and records is to permit it to prepare accurate tax returns, the government might be able to argue that a statement in corporate books and records is a statement "for tax purposes," within the letter of *McMillan/Beltzer*. In contrast, under the reformulation, the statement must be made to the Service.[89] Although the Service may ask to see business books and records, they are not prepared for the IRS. Thus, statements in a tax-

[87] In Tennessee Prods. Corp. v. United States, 107 F. Supp. 578 (Ct. Cl. 1952), the taxpayer made oral statements to a revenue agent with respect to one audit cycle. The Service argued that the duty of consistency bound the taxpayer to that representation in later years. The court (although on different grounds) disagreed. Because the proposed rule requires that the taxpayer's prior representation be in writing, it would cover the *Tennessee Products* result.

[88] See, e.g., McCulloch Corp. v. Commissioner, 48 T.C.M. (CCH) 802, 809-10 (1984); Deviney Constr. Co. v. Commissioner, 36 T.C.M. (CCH) 413, 414 (1977).

[89] The reformulation would ratify the result in Shook v. United States, 713 F.2d 662 (11th Cir. 1983). In that case, the taxpayer's representative wrote a letter to the taxpayer, and the Service asserted that the duty of consistency bound the taxpayer to the statements in that letter. Because the letter was not sent to the Service, the circuit court's decision against the government was appropriate. Id. at 662.

payer's books and records would not be prior representations which it could not, under the duty of consistency, attempt later to deny.

B. Commissioner's Reliance

The proposal eliminates the second element of the old triune standard which required the Commissioner's acquiescence in or reliance on the taxpayer's representation of fact. This element provides an unfortunate opportunity to apply two of the traditional equitable estoppel factors. The "acquiescence or reliance" language invites the court to consider whether the Service had actual or constructive knowledge of the facts. Similarly, the reference to "fact" opens the door to the "representation of fact versus representation of law" dichotomy. As suggested below, it is desirable to remove these and other equitable estoppel factors from consistency analysis.

At the outset, it is useful to divide the traditional equitable estoppel elements into two categories: Some elements relate to the fact that a harm or detriment has occurred; other elements seek to assign responsibility for that result to one or the other of the litigants. Five elements of the second kind—those seeking to measure the relative degrees of culpability of the taxpayer and the Service—have appeared in consistency decisions. They are: (1) whether the taxpayer's initial representation was made with an intent to mislead or deceive the Service;[90] (2) whether the taxpayer had knowledge of the true facts when he made his initial representation;[91] (3) whether the Service had adequate knowledge of the facts, or opportunity to gain such knowledge, before the statute of limitations expired as to the year of the initial representation;[92] (4) whether the taxpayer's initial representation was one of fact or one of law;[93] and (5) whether the error resulted from the taxpayer's unilateral action or from a mutual mistake of the taxpayer and the Service.[94]

This article advocates the excision of these culpability-based estoppel factors from consistency analysis. The incorporation of these elements is conceptually anomalous, is founded on an unsatisfactory model of tax administration and creates an unacceptable degree of unpredictability.

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[90] E.g., Cleveland-Sandusky Brewing Corp. v. Commissioner, 30 T.C. 539, 544-45 (1958); Grauman's Greater Hollywood Theatre, Inc. v. Commissioner, 37 B.T.A. 448, 449 (1938).

[91] E.g., Crosley Corp. v. United States, 229 F.2d 376, 380-81 (6th Cir. 1956); Van Antwerp v. United States, 92 F.2d 871, 875 (9th Cir. 1937).

[92] E.g., Southern Pac. Transp. Co. v. Commissioner, 75 T.C. 497, 560 (1980); Atlas Oil & Ref. Corp. v. Commissioner, 22 T.C. 552, 560 (1954).

[93] E.g., Joplin Bros. Mobile Homes, Inc. v. United States, 524 F. Supp. 800, 803 (W.D. Mo. 1981); United States v. Du Pont, 47 F. Supp. 894, 897 (D. Del. 1942).

[94] E.g., Manhattan Bldg. Co. v. Commissioner, 27 T.C. 1032, 1042 (1957); Capital Nat'l Bank v. Commissioner, 16 T.C. 1202, 1209-10 (1951).

First, conceptually, after hundreds of consistency decisions over 60 years, it is too late to deny that the duty of consistency is a doctrine of law discrete from the doctrine of equitable estoppel. Even courts that import estoppel elements into the duty of consistency admit this proposition.[95] Incorporationism, however, cannot be reconciled with the discreteness of the two doctrines. If the duty of consistency applies to a case only if all the elements of equitable estoppel are present, the government could never win a case on consistency grounds that it could not win on estoppel grounds. Thus, those cases that acknowledge the separateness of the doctrines, but conflate them by conditioning application of one on satisfaction of the elements of the other, contradict in practice what they assert in theory. Furthermore, the merger of the doctrines is difficult to defend historically. While equitable estoppel undoubtedly was one of the sources of the consistency duty, it was neither the sole source nor even the major one.[96] Thus, it is difficult to hinge the duty upon satisfaction of the elements of equitable estoppel.

Second, culpability-based factors do not comport well with a satisfactory model of tax administration. In a private lawsuit, it may be sensible for the court to ask which party behaved less laudably and make its estoppel rulings on that basis. That bipolar model, however, does not work well in suits involving revenue. Tax cases are not private affairs between the taxpayer and the Service alone; the citizenry has a stake in these cases.[97] Thus, when a taxpayer who has underpaid his taxes is allowed to avoid a consistency adjustment because the Service has operated laxly, the Service is not the only loser. The hypersensitivity of these factors in assessing the relative blameworthiness of the two visible parties ignores the interests of the invisible, but crucial, third party.

Finally, incorporation of culpability-based factors undercuts predictability. Predictability in law is a function of definable principles. However, moralistic decisionmaking, which is the inevitable result of factors that require the court to evaluate the relative culpabilities of the parties, rarely yields precise analysis or definition. Such decisions are more concerned with punishing or rewarding the litigants before the court than with marking boundaries for those who come later.

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[95] See, e.g., *Crosley*, 229 F.2d at 380-81; Ross v. Commissioner, 169 F.2d 483, 493-96 (1st Cir. 1948).

[96] Hess v. United States, 537 F.2d 457, 462 (Ct. Cl. 1976) (the duty of consistency "is not merely an equitable defense, such as the word 'estoppel' normally denotes . . . but [is] more in the nature of a legal defense"); Comar Oil Co. v. Helvering, 107 F.2d 709, 711 (8th Cir. 1939) (duty of consistency based upon an entirely different ground from equitable estoppel).

[97] Theodore Tannenwald, Jr., Tax Court Trials: A View from the Bench, 59 A.B.A. J. 295, 295 (1973) ("[U]nlike the ordinary tort or contract case, the other real party in interest is the taxpaying public. If the taxpayer gets off the hook for what he really should be required to pay, the pockets of all have been depleted.").

The ambiguities introduced by the culpability-based factors operate at three levels: (1) ambiguities as to which particular estoppel factors are to be incorporated and which are not; (2) ambiguities as to the meaning of individual factors; and (3) ambiguities as to the burden of proof with respect to these factors.

The most fundamental ambiguity relates to whether all five of the culpability-based estoppel factors are to be incorporated into consistency doctrine and, if not, which of them are dispensable. Numerous cases have held that the duty of consistency can apply "even though all the technical elements of estoppel are not present."[98] Other cases, however, have held that all of the elements of equitable estoppel must be satisfied before the duty of consistency can be applied, at least under some circumstances.[99] Furthermore, most cases stating that some of the estoppel factors are, in theory, expendable have not enumerated the factors that can be omitted, and the relatively few decisions achieving any degree of specificity[100] have engendered no consensus. These conflicting precedents make prediction as to the outcome of a consistency case hazardous.

Unpredictability also arises from confusion as to the meaning of particular estoppel factors. The best example is the factor considering IRS knowledge. It is unclear at what point the Service's actual or constructive knowledge of the facts has reached the critical mass needed to disqualify application of the duty of consistency. Although there are two fairly settled points—(1) the Service is not compelled to audit the year of the first representation;[101] and (2) if the Service audits the first year, it is not required to hunt for information from sources beyond the taxpayer[102]—little else is clear. Both the amount of knowledge required and whether the knowledge may be constructive as well as actual vary greatly from decision to decision.[103] Thus, when the consistency issue turns on the IRS knowledge factor, the outcome of the case is rarely predictable.

[98] E.g., Interlochen Co. v. Commissioner, 232 F.2d 873, 877-78 (4th Cir. 1956); Continental Oil Co. v. Jones, 177 F.2d 508, 512 (10th Cir. 1949).

[99] E.g., Crosley Corp. v. United States, 229 F.2d 376, 380 (6th Cir. 1956).

[100] Wichita Coca Cola Bottling Co. v. United States, 152 F.2d 6, 8 (5th Cir. 1945), cert. denied, 327 U.S. 806 (1946) (intent to deceive element); Orange Sec. Corp. v. Commissioner, 131 F.2d 662, 663 (5th Cir. 1942) (fact versus law element); Alamo Nat'l Bank v. Commissioner, 36 B.T.A. 402, 404-05 (1937), aff'd, 95 F.2d 622 (5th Cir.), cert. denied, 304 U.S. 577 (1938) (Service knowledge element).

[101] Commissioner v. Liberty Bank & Trust Co., 59 F.2d 320, 325 (6th Cir. 1932).

[102] See, e.g., Lofquist Realty Co. v. Commissioner, 102 F.2d 945, 949 (7th Cir. 1939); Robinson v. Commissioner, 100 F.2d 847, 849-50 (6th Cir.), cert. denied, 308 U.S. 567 (1939).

[103] Compare Erickson v. Commissioner, 61 T.C.M. (CCH) 2073, 2077-78 (1991) (Service deemed to have sufficient knowledge if exposed to key information in any fashion, whether or not connected with audit of taxpayer for period of first representation) with Mayfair Minerals, Inc. v. Commissioner, 56 T.C. 82, 91-93 (1971), aff'd per curiam, 456 F.2d 622 (5th Cir. 1972) (fortuitous exposure insufficient). The latter view is consistent with the refusal of courts in other areas to hold the Service accountable for all information in any of its offices regardless of how connected to or estranged from the particular taxpayer and tax years involved. See, e.g.,

Uncertainty as to the meaning of other factors abounds as well. The "fact versus law" element is predictable in its application only to the extent that representations can be distinguished between fact and law. While this will be possible in some cases, it will not be feasible in all.[104]

Finally, the burden of proof rule is also unstable as it relates to the culpability-based factors. Generally, it is held that the duty of consistency is an affirmative defense which must be specifically pleaded and proved by the government.[105] To discharge its burden of proof, the government must affirmatively establish facts satisfying all the elements. However, when the court finds that the taxpayer was the more blameworthy party, it occasionally ignores the fact that strict application of the burden of proof to the culpability elements would yield a different result, finding a way around the rule that the government must affirmatively prove each element of the duty of consistency, including the incorporated culpability-based estoppel elements.[106] Conversely, when the court feels that the Service's conduct was as bad or worse than the taxpayer's, it sometimes will find failures of proof that, in fairness, are not presented by the case. A court that dislikes the whole notion of the duty of consistency often can find a way to phrase its opinion in burden of proof language.[107] When a court either excuses failures of proof or finds proof problems that are not present, the duty of consistency is rendered less predictable in application. Such abuses are the natural result of the moralistic flavor of the culpability-based factors.

Burdening the duty of consistency with the culpability-based factors of equitable estoppel was an infelicitous importation. The approach is conceptually anomalous, reflects an unsatisfactory model of tax administration and renders consistency doctrine largely unpredictable in practice. Thus, these factors should be removed from consistency analysis.

O'Harren v. Commissioner, 60 T.C.M. (CCH) 20, 22-23 (1990) (knowledge of misguided filing not attributed to office where filing should have been made).

[104] Tax return representations generally mix factual components and legal components, rendering it difficult to confidently classify them purely as one type or the other.

[105] E.g., Helvering v. Salvage, 297 U.S. 106, 109 (1936); Barbados #7 Ltd. v. Commissioner, 92 T.C. 804, 813 (1989); Kutsunai v. Commissioner, 45 T.C.M. (CCH) 1179, 1182 (1983).

[106] For example, in Mayfair Minerals, Inc. v. Commissioner, 456 F.2d 622 (5th Cir. 1972) (per curiam), the taxpayer contended that the duty of consistency did not apply because the Service knew the true facts before expiration of the limitations period and because the parties had made a mutual mistake of law. The court responded: "This argument fails for lack of support in the record." Id. at 623. So put, the accepted burden of proof has been reversed. See also Commissioner v. Liberty Bank & Trust Co., 59 F.2d 320 (6th Cir. 1932).

[107] See, e.g., Fidelity-Philadelphia Trust Co. v. Commissioner, 5 B.T.A. Memo. Dec. ¶ 36,244 (1936), aff'd per curiam, 93 F.2d 1001 (3d Cir. 1937).

C. *Change in Representation*

An element of the reformulation is that the "[t]axpayer desires to change the representation, previously made, at a time when correction of the previous representation would be effectively prevented by the statute of limitations." This element raises three issues: (1) What constitutes an inconsistency or a change of a prior representation? (2) When can inconsistencies affecting only one tax period be corrected? and (3) When is correction "effectively" prevented by the statute of limitations?

1. *Inconsistency Defined*

Although a concept of what renders representations inconsistent would seem a prerequisite to the application of the duty of consistency, there is no general definition of inconsistency. While a case-by-case approach may have caused no great harm in most instances, there are a number of questionable results which could have been avoided with a serviceable definition of inconsistency. A principal problem has been the tendency of some decisions to treat inconsistency questions as an exercise in linguistic literalism. The law would be served better by focusing on the practical consequences of successive representations.

Thus, this article proposes the following standard: An inconsistent representation is made whenever the basis on which the Service's current adjustment is being resisted would, if accepted as correct, leave no satisfactory ground on which a previous tax result claimed by the taxpayer could be defended as having been correct.

The operational difference between the literal approach and the practical effect approach advocated here is illustrated by *Sanders v. Commissioner.*[108] The taxpayers had developed a scheme to manufacture additional deductions for their closely held corporation. Each December, the corporation accrued bonuses to the taxpayers, who were employees as well as shareholders. In the succeeding March, the bonuses were paid out by check which the recipients endorsed back to the corporation. The bonuses were then credited to officer loan accounts on the corporation's books. The taxpayers later drew amounts against these accounts, but did not include them in income. The officer loan accounts subsequently were closed out on the corporate books.[109]

In the first round of litigation the taxpayers successfully argued that, because the bonuses were shams, they should not be charged with salary income in the year of payment even as to the amounts they withdrew

[108] 32 T.C.M. (CCH) 332 (1973). A previous round of litigation, Sanders & Sons, Inc. v. Commissioner, 26 T.C.M. (CCH) 671 (1967), had involved some of the same issues for earlier tax years.

[109] *Sanders*, 32 T.C.M. (CCH) at 334-35.

from the loan accounts. Since the Service did not argue that these amounts were taxable as dividends, they escaped tax entirely in the earlier years.[110] The Service subsequently maintained that the amounts withdrawn from the loan accounts constituted income to the taxpayers in the year the loan accounts were closed out. The taxpayers defended on the ground that these amounts were includable in income in the earlier years, not in the year the accounts were closed. The Service asserted that the duty of consistency precluded the taxpayers from taking that position. The Tax Court held the duty inapplicable because, in its view, the taxpayers had not made inconsistent representations. The court reasoned that, in the first round of litigation, the taxpayers had argued simply that the bonuses were not salary or compensation and neither side had pursued the notion that the withdrawals were dividends.[111]

As to the duty of consistency issue, *Sanders* was wrongly decided. The taxpayers had made two prior representations, not one: (1) They explicitly represented that the withdrawn amounts were not salary income in the earlier years and (2) by omitting these amounts from their returns, they implicitly represented that the withdrawals were not income of any kind. The *Sanders* court tested the taxpayers' subsequent representation against only the first of the two prior representations. It did not take into account the fact that the taxpayers' subsequent representation—that the withdrawn amounts were income in the earlier years—cannot be squared with the implicit representation in their returns that the amounts were not income of any kind in those years.

Under the standard advocated, *Sanders* would have been decided differently. The position on which the *Sanders* taxpayers resisted the later adjustment was that the income was includable in previous years. If so, there would have been no satisfactory way to defend as correct the previous tax result claimed by the taxpayers, i.e., that the income not be included in those years.

2. *Inconsistency Affecting Only One Tax Period*

Most duty of consistency cases involve inconsistencies involving two or more tax periods, so much so that it often is convenient to speak of the duty as aimed at multi-year discrepancies. Nevertheless, the doctrine may apply to an intra-period inconsistency when the effect of permitting that inconsistency would be to close the period to correction under the statute of limitations. The reformulation reflects this by substituting "at a time when correction of the previous representation would be effectively prevented by the statute of limitations" for the language of the old

[110] Id. at 336-37.
[111] Id. at 340-41.

triune standard "in a later year after the first year has been closed by the statute of limitations."

Griffith v. Commissioner[112] is an example of inconsistent representations relating to one year. The taxpayer was represented during the audit by an unenrolled return preparer who, at the taxpayer's request, executed consents extending the statute of limitations for two years,[113] despite the fact that Service rules deny such power to an unenrolled preparer.[114] The Service determined deficiencies for those years. The taxpayer asserted that the consents were invalid because they had been signed by an unenrolled preparer and thus the statutes of limitations had expired.[115] The court applied the duty of consistency, finding that the taxpayer had represented either that the unenrolled agent had the requisite authority or that the taxpayer was ratifying his actions. The taxpayer was bound by that representation and could not later reject it.[116]

Although the case entailed no conflict between representations made as to different tax years, the reformulation would confirm the *Griffith* holding. Had the consents been held invalid, it would have been impossible for the Service to have protected the statute of limitations by obtaining new consents.[117] Accordingly, the subsequent inconsistent position was put forth "at a time when correction of the previous representation would be effectively prevented by the statute of limitations." In such cases, the duty of consistency should operate against intra-period inconsistencies.

3. *Effective Closure of Limitations Period*

The Service cannot make a consistency adjustment unless, at the time the subsequent, inconsistent representation is made, the statute of limitations has run for the period affected by the prior representation. How literally should this rule be applied? Suppose, for example, the taxpayer advances his subsequent, inconsistent position only a few days before the statute of limitations expires for the period of the first representation.[118] Because it would be impossible for the Service in the time remaining to issue a notice of deficiency with respect to that first tax period, the consistency adjustment to the subsequent period should be permitted. A rule permitting consistency adjustments when the prior tax period is *effec-*

[112] 56 T.C.M. (CCH) 220 (1988), supplemental opinion, 56 T.C.M. (CCH) 1263 (1989).

[113] Id. at 224-25.

[114] Rev. Proc. 68-20, ¶ 4.02(c), 1968-1 C.B. 812.

[115] *Griffith*, 56 T.C.M. at 225.

[116] Id. at 226.

[117] The limitations period may not be extended by a consent signed after the limitations period otherwise has expired. E.g., Melahn v. Commissioner, 9 T.C. 769, 776-78 (1947).

[118] See, e.g., Van Antwerp v. United States, 92 F.2d 871, 872 (9th Cir. 1937) (inconsistent position taken one day before statute of limitations expired).

tively closed to correction under the statute of limitations is calculated to discourage blatant manipulation by inconsistent taxpayers.[119]

A corollary issue is the amount of time the Service reasonably should be given to issue a notice of deficiency or make an assessment with respect to the tax period of the prior representation. Although a number of analogies are available[120] that might suggest a rule, the best is found in Form 872-A which extends the limitations period until the ninetieth day after, inter alia, the Service office handling the matter receives from the taxpayer a termination of the extension. This suggests that the Service is capable of issuing a notice of deficiency within 90 days after the triggering event—in that context, receipt of a notice from the taxpayer and, in this context, receipt of the second representation. Accordingly, the 90-day point is a serviceable starting demarcation. The statute of limitations should be treated as effectively closed if the subsequent, inconsistent position is brought to the Service's attention when fewer than 90 days remain on the statute of limitations governing the tax period as to which the prior representation was made.[121]

D. *Affirmative Defenses*

Upon satisfying the previously described elements,[122] the government should be held to have made out a prima facie case for application of the duty of consistency. The taxpayer could attempt to defeat the consis-

[119] One court precluded the taxpayer from shifting his position when the subsequent representation was made to the Service at the height of the filing season and only 16 days before expiration of the limitations period as to the first tax year. Mann v. Anderson, 20 F. Supp. 643, 646 (S.D.N.Y. 1937); cf. Joyce v. Gentsch, 141 F.2d 891, 896 (6th Cir. 1944) (denying the consistency adjustment, but noting that the Service possessed the essential facts "[f]or a sufficient period of time" before expiration of the statute of limitations period).

[120] See, e.g., IRC § 6501(d) (usual three-year limitations period can be reduced to 18 months if a request for prompt assessment is filed with the Service); IRC § 6229(f) (one-year assessment period against partners when their partnership items subject to the unified audit rules become non-partnership items); IRC § 6503(j)(1) (statute of limitations is suspended for at least 60 days, or 120 days if a court orders compliance with the summons, if a designated summons is issued with respect to a corporate return). The lengthy periods of §§ 6501(d) and 6229(f) would restrict taxpayers unduly. Section 6503(j)(1) contemplates an audit already in progress, which may not be true when the taxpayer attempts to withdraw the prior representation. Another analogy is suggested by the Bankruptcy Code. A bankruptcy trustee may request from the Service a determination of the amount of certain unpaid tax liabilities of the bankruptcy estate. Generally, any deficiency determined by the Service more than 180 days after such a request is submitted is void. 11 U.S.C. § 505(b)(1)(B) (1988). This suggests that Congress believes the Service should be able to start and finish an audit within 180 days of its being notified of the need to conduct one.

[121] To a certain extent, the taxpayer would be in control of the situation since, if fewer than 90 days remained in the limitations period, the taxpayer could offer to execute a consent extending the period sufficiently that the attempted withdrawal would be more than 90 days before expiration of the statute. See IRC § 6501(c)(4).

[122] See Sections IV.A, IV.C.

tency adjustment by negating one of the elements of the Service's case. The reformulation would give the taxpayer a further opportunity to defeat the consistency adjustment by allowing him to attempt to prove that there is an affirmative defense to the duty of consistency. The remainder of this section discusses the applicable burden of proof and the specific affirmative defenses which should be available to taxpayers.

1. Burden of Proof

The government now bears the burden of pleading and proving a consistency adjustment although this precept sometimes is applied loosely.[123] In contrast, under the reformulation, the burden of proof would be split: The government would bear the burden of establishing the elements of its prima facie case and the taxpayer would bear the burden of establishing any affirmative defenses. The burden of pleading would follow the burden of proof: The government would be obliged to plead in its answer the elements of its prima facie case and the taxpayer would be required to plead in its reply any special defenses.

There is ample precedent in tax practice for splitting the burden of proof. It has become conventional to divide the burden of proof into two aspects: the risk of nonpersuasion and the burden of production (also called the burden of going forward). Often the taxpayer bears the risk of nonpersuasion as to some of the issues while the Service bears that risk as to other issues.[124] Even as to individual issues, the Code splits the risk of nonpersuasion in a number of instances.[125] Moreover, the burden of going forward as to an individual issue can shift from one party to the other party.[126] Thus, the technique advocated here—splitting the burden of proof as to the duty of consistency between the taxpayer and the Service—entails nothing more than the application to the consistency doctrine of an accepted approach.

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[123] See text accompanying notes 105-07.

[124] In deficiency actions, the taxpayer bears the burden of persuasion as to the adjustments contained in the notice of deficiency (with certain specified exceptions), but the Service bears the burden as to any new issues it raises subsequent to the notice. E.g., Tax Ct. R. 142. In refund actions, the burden of persuasion as to the cause of action is on the taxpayer, but a complex allocation of the burden exists as to setoffs asserted by the government. See, e.g., Missouri Pac. R.R. v. United States, 338 F.2d 668 (Ct. Cl. 1964).

[125] See IRC § 6902(a) (transferee liability for unpaid taxes); IRC § 7429(g)(1), (2) (jeopardy and termination assessment).

[126] See, e.g., IRC §§ 533(a), 534(a)-(c); Reg. §§ 1.533-1(a), (b); 1.534-2(b), (d) (accumulated earnings tax); United States v. Powell, 379 U.S. 48, 57-58 (1964) (summons enforcement); Murray v. United States, 292 F.2d 602, 603-04 (1st Cir. 1961) (statute of limitations); Kamholz v. Commissioner, 94 T.C. 11, 16-17 (1990) (injunction).

2. Affirmative Defenses

This section proposes three affirmative defenses that should be available to taxpayers to defeat the duty of consistency even though the government has made its prima facie case. They are: (1) The statute of limitations on the period of the first representation, although closed, can be reopened under the mitigation provisions; (2) the taxpayer or his related person did not realize tax savings from the first representation; and (3) the taxpayer attempted to withdraw the first representation before the effective close of the statute of limitations on the first tax period.

In each case, this section establishes why the defense should defeat the duty and why the burden of proof should be on the taxpayer rather than the government. The focus in the first inquiry is on the policy values enhanced by the duty of consistency. The second inquiry is primarily concerned with the three elements that customarily govern the allocation of the burden of proof: policy, probability and possession of proof.[127]

a. *Applicability of Mitigation Provisions*

Sections 1311 to 1314 describe conditions under which the government may assert a deficiency (or the taxpayer claim a refund) despite the fact that the statute of limitations for the applicable period has expired.[128] When, as occasionally is the case, both the mitigation provisions and the duty of consistency could apply to the same controversy, the mitigation regime should preempt. The mitigation sections correct the tax period affected by the first representation while the duty of consistency operates on a subsequent tax period. Since many factors affecting calculation of tax liability could change between the two periods, correcting the original period entails greater precision and obviates the possibility of undercorrection or overcorrection. Thus, the availability of the mitigation remedy should be a defense against the duty of consistency.

This special defense should be pleaded and proven by the taxpayer. Probability is one of the factors that usually govern allocation of the burden of proof. In applying this factor, courts "ask 'what will be the probable state of facts in most cases?' so that the burden of showing an idiosyncratic course of events can be placed on the party asserting the unusual."[129] This consideration suggests that the taxpayer should bear the burden of proving that the mitigation provisions would apply to the case. Were the nonavailability of mitigation an element of the Service's prima facie case, mitigation would have to be analyzed and briefed in

127 See, e.g., 21 Charles A. Wright & Kenneth W. Graham, Federal Practice & Procedure: Evidence § 5122 (1977).

128 The statutory mitigation provisions and their relationship to the duty of consistency are discussed in detail in Section V.A.

129 Wright & Graham, note 127, at 557.

every consistency controversy. The mitigation provisions, however, will not apply in most consistency cases.[130] Since it would be a waste of trial resources to require analysis of these sections in every case, allocating the burden of proof to the taxpayer is more efficient.

b. *Absence of Prior Tax Saving*

Case law on the duty of consistency suggests somewhat ambiguously that the duty should apply only if the taxpayer's prior representation was tax advantageous.[131] The *McMillan/Beltzer* standard does not formally require that the prior representation reduce the taxpayer's or related person's tax bill, and the *Beltzer* district court stated that the enumerated elements are the "sole" conditions for application of the duty.[132] On the other hand, several decisions before and after *Beltzer* refused to hold the taxpayer to the prior representation because it produced no tax saving.[133]

Under the reformulation, the taxpayer's failure to benefit from the first representation would prevent application of the duty of consistency. The policy values previously discussed generally would not be offended by allowing a "no benefit" exception. Moreover, the goal of determination of correct tax liability on an overall basis would be enhanced. Without the exception, the taxpayer would have paid the right amount or too much tax for the period of the first representation and, because the duty of consistency would prevent him from shifting to a correct revised position for the later period, also would pay too much tax for the later period. Allowing a "no benefit" exception to the duty of consistency would ameliorate this bias by allowing the taxpayer to shift to a different position in the later year if the new position is substantively correct and the prior position was not. On an overall basis, the total tax paid would be correct or, at a minimum, closer to correct than the result reached under the duty of consistency without a no benefit exception. Thus, the proposal creates an exception to the duty of consistency for those instances in which the representation made for the first period, compared to a possible alternative representation which would have been consistent with the later representation, did not yield a tax saving for the taxpayer or related person.

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[130] See text accompanying notes 150-57.

[131] Many cases refer to the duty of consistency operating to prevent a tax windfall for the taxpayer or, its flip side, an undue revenue detriment to the government. E.g., Building Syndicate Co. v. United States, 292 F.2d 623, 626 (9th Cir. 1961); Brown v. United States, 292 F. Supp. 527, 532 (D. Or. 1968); Garner v. Commissioner, 42 T.C.M. (CCH) 1181, 1187 (1981).

[132] Beltzer v. United States, 73-2 U.S.T.C. ¶ 9512, at 81,620 (D. Neb. 1973), aff'd, 495 F.2d 211 (8th Cir. 1974).

[133] E.g., Georgia Properties Co. v. Henslee, 138 F. Supp. 587, 590 (M.D. Tenn. 1955); Union Carbide Corp. v. United States, 612 F.2d 558, 566 (Ct. Cl. 1979); Deviney Constr. Co., Inc. v. Commissioner, 36 T.C.M. (CCH) 413, 415 (1977).

The burden of proving the no benefit exception should be on the taxpayer. Although some courts would place the burden of proving prior benefit on the Service, making the duty of consistency inapplicable when that burden is not discharged,[134] this approach is ill-advised. Based on both probability and possession of proof, this exception should be an affirmative defense to be proven by the taxpayer rather than an element of the Service's prima facie case.

First, as with the mitigation remedy special defense, the no benefit defense likely will operate in relatively few cases. In taking a position, a taxpayer is not oblivious to consequences and generally will incline toward the position yielding the lowest tax bill. Given the probabilities, making the Service prove benefit in every case, when lack of benefit will exist in few, would be an inefficient use of trial resources.

Second, the possession of proof consideration adverts to the relative access of the parties to the facts needed to discharge the burden of proof. The burden usually should be on the party with the greater capacity to marshall the relevant information.[135] In this instance, the taxpayer is clearly that party. The taxpayer and his representatives will know far better than the Service what considerations prompted the choice of one representation over another, including the calculations of the relative tax effects of the alternatives. Also, since consistency controversies often span decades, the Service may not have retained its files or even the original return. A taxpayer is more likely to have preserved books and records and copies of tax returns and tax files.

Finally, there is a question whether the no benefit defense should advert to the specific amount of the tax saving. This affirmative defense could be constructed along either of two lines. It could be the rule that the defense would fail if the first representation produced any tax saving at all in the year with respect to which it was made, whether that saving was less than, equal to or more than the amount of tax that would be recouped in the subsequent period by precluding the shift to an inconsistent position. Alternatively, the rule could be that the amount of the consistency adjustment in the subsequent period would be capped at the amount of the tax saving realized by the taxpayer for the prior period.

For two reasons, this article rejects the second approach and recommends that the no benefit defense should fail whenever the prior representation was tax advantageous, irrespective of the amount of such advantage. First, a dilemma exists with respect to interest on the tax saving for the prior period. Were the cap computed without reference to

[134] E.g., Hunt v. Commissioner, 27 T.C.M. (CCH) 791, 797-98 (1968).

[135] The burden should be on the party "on whom it would sit lightest." Jeremy Bentham, quoted in James B. Thayer, The Burden of Proof, 4 Harv. L. Rev. 45, 59 (1890); see, e.g., Campbell v. United States, 365 U.S. 85, 96 (1961); Church of Scientology v. Commissioner, 83 T.C. 381, 468 (1984).

interest, the government would be prejudiced. If only the principal amount of the first year's saving must be restored in the subsequent year, the government effectively would be making interest-free loans (for years, sometimes for decades) to inconsistent taxpayers. On the other hand, the interest component would be large in most consistency cases, often in excess of the principal. In all likelihood, the total of the first year's saving plus interest thereon would exceed the amount of the consistency adjustment in the subsequent year in the overwhelming majority of cases. Thus, including interest usually would render the cap a dead letter.

Second, the approach advocated here would harmonize the duty of consistency with the tax benefit rule and the mitigation provisions, both of which are qualitative, not quantitative, in thrust. For example, the tax benefit rule does not apply when the previous deduction of the item produced no tax saving.[136] The focus is only on whether there was a saving; the amount is irrelevant.[137] The mitigation provisions, as they apply to cases of double exclusion of an item, look only to whether the item was present in the prior year; they are blind as to whether the item produced a greater tax effect in the prior year than it would produce in the subsequent year.[138]

c. *Timely Attempt to Withdraw Prior Representation*

The reformulation provides that an attempt by the taxpayer to recant the prior representation at some time before the later representation is made should be a defense against a consistency adjustment.[139] The values fundamental to the tax system are not traduced by such a defense. Moreover, it is a logical extension of the self-reporting system that taxpayers be encouraged to report to the Service any errors they detect in their prior tax representations.

However, it is necessary to guard against the obvious peril that the existence of such a defense might lead some taxpayers to assert spurious claims of attempts to withdraw. To deal with such claims effectively, the defense should be qualified in three ways:

> (1) The attempt to withdraw or correct the prior representation should not be admitted as a defense unless it was received by the Service in such a fashion and at such a

[136] IRC § 111(a); see California & Hawaiian Sugar Ref. Corp. v. United States, 311 F.2d 235, 238-39 (Ct. Cl. 1962); Central Loan & Inv. Co. v. Commissioner, 39 B.T.A. 981, 984 (1939).

[137] E.g., Alice Phelan Sullivan Corp. v. United States, 381 F.2d 399, 402 (Ct. Cl. 1967).

[138] E.g., United States v. Rachal, 312 F.2d 376, 380 (5th Cir. 1962); Cory v. Commissioner, 261 F.2d 702, 705 (2d Cir. 1958), cert. denied, 359 U.S. 966 (1959).

[139] Some courts agree. E.g., Atlas Oil & Ref. Corp. v. Commissioner, 22 T.C. 552, 559-60 (1954); Rosensteel v. Commissioner, 46 B.T.A. 1184, 1200-01 (1942).

time that the Service had reasonable opportunity to deal with it before expiration of the statute of limitations for the period as to which that representation was made. The rule as to when the statute of limitations is effectively closed to correction[140] should be applied to ascertain whether the attempted withdrawal was timely.

(2) The attempt to withdraw or correct the prior representation must be made to the Service in writing. This would reduce the possibility of this issue being decided on conflicting testimony about ambiguous words and actions.

(3) The attempted withdrawal must be clear and apparent.[141] The rules under former § 6661 (now § 6662(b)(2), (d)) describing the form and content of a disclosure statement sufficient to relieve the taxpayer of liability for the substantial understatement penalty[142] provide an analogy for what constitutes clear and apparent withdrawal of a representation for duty of consistency purposes.

The burden of proof as to this defense should be on the taxpayer. This would further protect against spurious claims. Moreover, the difficulty of trying to prove a negative is well known.[143] It makes more sense that the taxpayer should have to show that an attempt to withdraw was made than that the Service should have to show that no such attempt was made.

V. Relation to Other Means of Enforcing Taxpayer Consistency

The duty of consistency does not exist in a vacuum. A number of other mechanisms bear on the problem of taxpayer inconsistency, and the relation of the duty to these other vehicles merits exploration. Hitherto, that exploration has been less than thorough. Most courts have been content to discuss one of the mechanisms without reconciling it to others. This section considers in detail the relationship of the duty of consistency to other statutory, regulatory and judicial devices addressing taxpayer inconsistency.

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140 See text accompanying notes 118-21.

141 See Mayfair Minerals, Inc. v. Commissioner, 56 T.C. 82, 91 (1971), aff'd per curiam, 456 F.2d 622 (5th Cir. 1972) (enigmatic disclosure buried on a schedule M attached to a Form 1120 insufficient).

142 See Reg. § 1.6661-4.

143 See, e.g., Llorente v. Commissioner, 649 F.2d 152, 156 (2d Cir. 1981).

A. Relation to Statutory and Regulatory Anti-Inconsistency Rules

The Code and regulations contain many provisions designed to deter, correct or punish inconsistent positions taken by taxpayers in different tax periods. Examples include the accounting method rules under § 446,[144] the inventory accounting rules under § 471,[145] the rules relating to adjustments required by a change in accounting method under § 481[146] and a variety of other provisions.[147]

While these measures certainly are meaningful within their demesnes, their limited scope is such that a general anti-inconsistency doctrine is necessary. A review of the most important statutory anti-inconsistency mechanism—the statute of limitations mitigation provisions[148]—makes this clear.

The mitigation provisions allow the government to pursue a deficiency, or the taxpayer to seek a refund, even though the statute of limitations has expired for the period in question. Taxpayer inconsistency is a central concept of the mitigation provisions. The legislative history makes it clear that a purpose of the mitigation provisions is to take "the profit out of inconsistency . . . whether fortuitous or the result of design."[149]

Although the mitigation provisions and the duty of consistency generally address the same problem, they differ in two key respects: effect and coverage. If the mitigation provisions apply, the Service is permitted to correct the error in the otherwise closed tax period. If the duty of consistency applies, correction occurs in the open period by binding the taxpayer to a position in that period that is consistent with her representation in the closed period.

The coverage of the mitigation provisions is far less extensive than that of the duty of consistency. Mitigation "does not purport to permit the correction of all errors and inequities."[150] Reflecting this, the mitigation sections are hedged with numerous technical rules circumscribing their applicability,[151] and at least some decisions have held that the sections

[144] See Reg. § 1.446-1(a)(2).

[145] See Reg. § 1.471-2(b).

[146] See Reg. § 1.481-1(a)(1).

[147] See, e.g., IRC § 338(f), (h)(4); Temp. Reg. § 1.338-4T(b)(5), (g) (§ 338 elections); IRC § 461(h)(3)(A)(iii) (recurring items exception to the economic performance rule); IRC § 6222(a) (reporting TEFRA partnership items); Rev. Rul. 85-18, § 3.04, 1985-1 C.B. 518 (relief provisions for employment tax); Rev. Rul. 65-297, 1965-2 C.B. 152 (installment method rules).

[148] IRC §§ 1311-1314.

[149] S. Rep. No. 1567, 75th Cong., 3d Sess. 49 (1938), reprinted in 1939-1 C.B. (pt. 2) 779, 815.

[150] Brennen v. Commissioner, 20 T.C. 495, 500 (1953).

[151] With a variety of exceptions and additional elements, § 1311 relief depends on there being (1) an error made in an otherwise closed tax period, (2) a determination as to the item made with respect to another tax period or related taxpayer, (3) a statutorily enumerated cir-

should be strictly construed.[152] Without traversing all galleries of the mitigation labyrinth, three perspectives make it clear that §§ 1311 to 1314 govern far less than the universe of taxpayer inconsistency.

First, the mitigation sections allow the reopening of a closed *income tax* period only.[153] These rules do not apply to inconsistency-induced underpayments of other kinds of tax. Second, even income tax underpayments cannot be corrected by the mitigation provisions when the prior inconsistency occurred with respect to a tax other than the income tax. An essential element of mitigation is that there be a "determination," i.e., a final judicial decision or administrative action establishing the correct tax treatment of the item.[154] Some courts have held that a decision or action with respect to a tax other than the income tax cannot constitute a determination for mitigation purposes.[155] For these courts, an underpayment of income tax is shielded from correction whenever the inconsistency relates to a tax other than the income tax, as frequently is the case.[156]

Third, a major category of inconsistency cases involves taxpayers who seek to exclude from both periods an income item that undoubtedly must be included in one of the periods. The mitigation sections often do not apply in these cases. The statute directs that in double exclusion of income cases, there is no mitigation if, at the time the Service first maintained its position as to the open year, the other year already was closed.[157] Because the two years often are separated by a decade or more, the statute of limitations may be closed on the first year by the time the Service discovers the inconsistency in the second year.

The partial overlap of the mitigation provisions and the duty of consistency requires a determination of the relationship of the two doctrines. One possible position is that, since Congress has enacted a statutory scheme of correction, resort to judicial doctrines of correction such as the duty of consistency is inappropriate, i.e., the statutory rules completely

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cumstance of adjustment, and (4) maintenance of an inconsistent position by the party prevailing in the determination. IRC §§ 1311(a), (b); 1312.

152 See, e.g., Commissioner v. Goldstein, 340 F.2d 24, 27 (2d Cir. 1965); Muntwyler v. United States, 82-1 U.S.T.C. ¶ 9252, at 83,553 (N.D. Ill. 1982), aff'd on other grounds, 703 F.2d 1030 (7th Cir. 1983); American Found. Co. v. Commissioner, 2 T.C. 502, 509 (1943). Contra O'Brien v. United States, 766 F.2d 1038, 1042 (7th Cir. 1985); First Nat'l Bank v. United States, 565 F.2d 507, 516 (8th Cir. 1977).

153 IRC §§ 1312, 1314(e); Reg. § 1.1311(a)-2(b).

154 IRC §§ 1311(a), 1313(a).

155 E.g., Provident Nat'l Bank v. United States, 507 F. Supp. 1197, 1200-02 (E.D. Pa. 1981); Evans Trust v. United States, 462 F.2d 521, 524-25 (Ct. Cl. 1972). Contra Chertkof v. United States, 676 F.2d 984, 987-90 (4th Cir. 1982).

156 For instance, the inconsistency often has been between an estate tax return and an income tax return of a beneficiary. E.g., Griffith v. United States, 71-1 U.S.T.C. ¶ 9280 (N.D. Tex. 1971); Church v. Commissioner, 37 T.C.M. (CCH) 1236 (1978).

157 IRC § 1311(b)(2)(A).

preempt the field. A second possible position is partial preemption, i.e., that the mitigation provisions trump the duty of consistency only when both regimes apply to the particular case. The third possible position is no preemption, i.e., that the duty of consistency should be allowed to operate in each particular case to which it applies regardless of whether the mitigation provisions also would apply to that case. For the reasons discussed below, this article advocates the partial preemption position.

1. Complete Preemption

In §§ 1311 to 1314, Congress crafted an exceedingly detailed response to the inconsistency problem. A possible inference is that Congress intended the detailed statutory rules to displace judicially crafted means of discouraging or correcting taxpayer inconsistency. Although few consistency cases address this inference, some courts incline toward[158] or against[159] complete preemption.

The issue has arisen in more focused fashion in litigation concerning another judicial rule, the doctrine of equitable recoupment. It is uncontroversial that equitable recoupment may apply when a case clearly falls outside the ambit of the mitigation provisions, for example, when the tax involved is other than the income tax.[160] However, a number of decisions have held that equitable recoupment does not apply when a case falls within the general area of the mitigation sections even though, for failure of one of the technical prerequisites, there is no mitigation in the case.[161]

Complete preemption should be rejected in the consistency context. First, the legislative history of the mitigation sections is revealing. In Congress' estimation, these sections were needed to "*supplement* the equitable principles applied by the courts."[162] This language lends little support to the notion that the mitigation provisions are exclusive and preempt judicial doctrines of correction.

Second, a parallel can be drawn to the tax benefit rule. Originally judicially created, that rule was partially codified in § 111. Yet, the judicial

[158] B.C. Cook & Sons, Inc. v. Commissioner, 59 T.C. 516, 521-22 (1972); cf. Canelo v. Commissioner, 53 T.C. 217, 227 (1969) (applicability of the mitigation provisions considered in determining whether to apply the tax benefit rule), aff'd per curiam, 447 F.2d 484 (9th Cir. 1971).

[159] Hess v. United States, 537 F.2d 457, 463 (Ct. Cl. 1976); Mayfair Minerals, Inc. v. Commissioner, 56 T.C. 82, 94 (1971), aff'd per curiam, 456 F.2d 622 (5th Cir. 1972).

[160] See, e.g., Boyle v. United States, 355 F.2d 233 (3d Cir. 1965); United States v. Bowcut, 287 F.2d 654 (9th Cir. 1961).

[161] E.g., Benenson v. United States, 385 F.2d 26, 32-34 (2d Cir. 1967); Brigham v. United States, 470 F.2d 571, 577-78 (Ct. Cl.), cert. denied, 414 U.S. 831 (1972). Contra Hufbauer v. United States, 297 F. Supp. 247 (S.D. Cal. 1968).

[162] S. Rep. No. 1567, note 149, at 815 (emphasis added).

rule continues.[163] If partial codification of the tax benefit rule does not preempt the remainder of the judicial rule, it would seem incongruous to hold that codification of the mitigation sections preempts application of the duty of consistency.

Third, the case for complete preemption is undercut by the fact that the duty of consistency and the mitigation provisions operate on different tax periods: the former on the open period and the latter on the closed period. This vitiates one of the rationales relied on in a leading complete preemption case, *Benenson v. United States.*[164] The court feared a circularity. It believed that resolving the equitable recoupment issue is indispensable to ascertaining whether the mitigation sections apply (since making a "determination" requires fixing tax liability arising from the transaction, which cannot be done without resolving the equitable recoupment issue), but resolving the mitigation issue is indispensable to ascertaining whether equitable recoupment applies (since a prerequisite to its application is that no adequate remedy at law, such as mitigation, is available).[165] *Benenson*'s reasoning in this regard is not entirely convincing, and the feared circularity does not appear to be an insuperable difficulty. Nevertheless, the important point is that, in a duty of consistency case, the court would not be trapped in any circularity since that duty and the mitigation provisions relate to different tax periods and so are not interdependent.

2. *Partial Preemption Versus No Preemption*

The choice is thus between partial preemption (the duty of consistency cannot be applied if the mitigation provisions would apply to the case) and no preemption (the duty of consistency may be applied whether or not the mitigation provisions also would apply). Relatively few decisions have confronted this issue. Those that have, incline to the partial preemption view.[166]

Four considerations support partial preemption. First, the mitigation provisions are statutory; the duty of consistency is entirely judicial. Because of congressional primacy in the field of taxation, it is natural to accord greater deference to a statutory arrangement than to a judicial rule when both apply to the same case.

Second, a no preemption regime would give the Service an excessive degree of choice about the means to correct inconsistency. Under such a

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163 Estate of Munter v. Commissioner, 63 T.C. 663, 671 (1975).

164 385 F.2d 26 (2d Cir. 1967).

165 Id. at 32 n.8.

166 See Crosley Corp. v. United States, 229 F.2d 376, 381 (6th Cir. 1956); Greenwood Packing Plant v. Commissioner, 131 F.2d 787, 790 (4th Cir. 1942); Kenosha Auto Transp. Corp. v. Commissioner, 28 T.C. 421, 425-26 (1957).

regime, the Service would have the option of asserting a deficiency in the open period under the duty of consistency or of asserting a deficiency in the closed period under the mitigation provisions. Presumably, the Service would make this choice with an eye to which approach would generate more revenue. Yet most tax professionals, tax administrators and taxpayers would feel more comfortable if the Service enforced clear rules with definite revenue consequences, rather than calculated the effects of alternative procedures and chose among them based on their revenue results.

Third, another consequence of choice is unpredictability and lack of uniformity. In all probability, the Service would choose to proceed with respect to the open period sometimes and the closed period other times, with no fixed principle other than revenue maximization to guide its choice. A congressional objective in enacting the mitigation provisions was to introduce greater uniformity and predictability into this area than had been achieved under judicial doctrines of correction.[167] A partial preemption rule would serve this end better than a no preemption rule.

Fourth, and most importantly, a partial preemption rule would better comport with the imperative of determining correct tax liability. As noted previously, when the open period is corrected under the duty of consistency, the potential for imprecision exists. There may be overcorrection or undercorrection of the error introduced in the closed period. Mitigation avoids this problem since it operates on the otherwise closed period.

But the matter is far from one sided. Substantial arguments can be arrayed in support of a no preemption rule. For the most part, these arguments sound in the potentially cumbersome procedural situation that partial preemption could engender. Partial preemption typically would entail two stages of litigation. Initially, the government's assertion of an underpayment for the open period based on the duty of consistency would be tested in a deficiency action or a refund action. In that action, the taxpayer would assert as a defense that the putatively closed period is subject to correction under the mitigation rules and, thus, that the duty of consistency is preempted. If the taxpayer prevails, the government would lose the underpayment for the open period. Resorting to mitigation, the government then would issue a second statutory notice of deficiency—this time with respect to the prior period—which could be contested by the taxpayer in a second case.

In attempting to avoid two stages of litigation, the common sense expedient would be for the government to issue one statutory notice which would assert a deficiency for the open period under the duty of consistency and, in the alternative, a deficiency for the closed period under the

[167] S. Rep. No. 1567, note 149, at 815.

mitigation provisions. If successful, this strategy would telescope the proceedings, allowing one court to make a determination as to the open year and then to decide whether the closed year could be reopened via the mitigation sections.

Unfortunately, this expedient is not possible. A determination is a prerequisite to mitigation,[168] and, in an unagreed case in which the Service is asserting an underpayment, the determination would have to be a court decision.[169] However, to constitute a determination, the court decision must be final. Since finality does not occur until after expiration of the appeal period,[170] the court making the determination lacks jurisdiction to grant § 1311 relief since the finality of its own judgment is prerequisite to such relief.[171]

Thus, unless the government prevails in the first case, the partial preemption view seems to require two levels of litigation. Several undesirable outcomes could eventuate. For one, taxpayers would be sorely tempted to resist the duty of consistency adjustment in the open year by assuring the court that the Service could reopen the closed year under the mitigation sections. Then, when the Service attempts so to do, the taxpayer would protest that the mitigation sections really do not apply to the case after all. An object of the duty of consistency is to discourage unseemly positional gymnastics by taxpayers. This object is not advanced by the two-stage litigation required by the partial preemption view.

A compounding problem is the possibility that the taxpayer might prevail at both stages, defeating both the consistency claim in the open year and the mitigation claim in the closed year, thus escaping proper tax entirely. Of course, this problem would materialize only if the courts in each case reach different conclusions as to whether the mitigation provisions apply. While hopefully this would not be a routine occurrence, given the hypertechnical contents of §§ 1311 to 1314,[172] the possibility cannot be excluded entirely.[173]

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168 IRC § 1311(a).

169 IRC § 1313(a)(1).

170 See, e.g., IRC § 7481(a), (b) (finality of Tax Court decisions).

171 See, e.g., Republic Petroleum Corp. v. United States, 613 F.2d 518, 527 (5th Cir. 1980); Cory v. Commissioner, 261 F.2d 702, 704-05 (2d Cir. 1958).

172 The mitigation provisions have been described as "among the most arcane and technical" sections of the Code. Gindes v. United States, 661 F.2d 194, 200 n.18 (Ct. Cl. 1981); see O'Brien v. United States, 766 F.2d 1038, 1041 (7th Cir. 1985).

173 For an actual example, see B.C. Cook & Sons, Inc. v. Commissioner, 59 T.C. 516 (1972) [hereinafter *Cook I*]; B.C. Cook & Sons, Inc. v. Commissioner, 65 T.C. 422 (1975) [hereinafter *Cook II*], aff'd per curiam, 584 F.2d 53 (5th Cir. 1978). The taxpayer's bookkeeper embezzled funds by writing checks for fictitious purchases, which were reflected on its return as part of cost of goods sold, thus reducing its taxable income. *Cook I*, 59 T.C. at 518. In a later year, the taxpayer discovered the embezzlement and claimed a theft loss deduction, which was disallowed by the Service. Id. at 519. The Tax Court upheld the claimed § 165 deduction despite

Finally, the two-stage litigation required by a partial preemption approach delays the final resolution of the controversy, multiplies the inconvenience and expense suffered by the parties, and places additional demands on limited judicial resources. These process costs should not be taken lightly.

Thus, there are strong arguments in favor of a no preemption rule, and the choice between such a rule and a partial preemption rule is a close one. Nevertheless, this article concludes that the arguments in favor of partial preemption are more persuasive. Additional taxpayer positional inconsistency, although unsavory, becomes seriously deleterious only if the strategy succeeds. To prevent that, we must depend on the courts, assisted by diligent counsel, to apply the law correctly. The process costs are troubling, but they are the price to be paid for the statutory scheme Congress established.[174]

In summary, the mere existence of §§ 1311 to 1314 should not preclude application of the duty of consistency when the facts of the case fall within the general ambit of those sections but mitigation cannot be effected due to failure of a technical element. However, when all technical elements are satisfied and the closed year is amenable to correction via mitigation, the government should be required to use such correction in preference to correcting the open year through the duty of consistency.

B. Relation to Other Judicial Anti-Inconsistency Rules

1. Reach of Other Judicial Rules

The duty of consistency is not the only judicially crafted device that can be brought to bear against taxpayer inconsistency. As noted previously, at least six such devices were ancestral to the duty: election, waiver, equitable estoppel, principles of contract, general equitable considerations in refund cases and statutory construction preference.

None of these doctrines can operate as a general substitute for the duty of consistency. Election and waiver apply to relatively few cases because, properly construed, they depend on the taxpayer's having an option as to tax treatment and the Code usually mandates how transactions are to be

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the fact that doing so allowed the taxpayer to reduce its taxable income twice on account of the same item. The court rejected the Service's consistency argument, advising the Service that its recourse was the mitigation sections. Id. at 522. The Service then issued a statutory notice for the year the cost of goods sold was improperly inflated, relying on the mitigation sections to oppose the taxpayer's statute of limitations contention. *Cook II*, 65 T.C. at 422, 425-26. Recanting its *Cook I* position, the Tax Court held for the taxpayer again, finding that cost of goods sold is not a "deduction" as that term of art is used in the Code, thus that there had been no double deduction so that the mitigation provisions did not apply after all. Id. at 428.

[174] See Benenson v. United States, 385 F.2d 26, 34 (2d Cir. 1967).

treated.[175] Equitable estoppel requires satisfaction of more elements than the duty of consistency and so will operate less often.[176] Contractual principles and the constructional preference are rare in contemporary tax litigation.[177]

The remaining ancestral theme—general equitable considerations in refund cases—has over the decades separated into three reasonably distinguishable doctrines: the duty of consistency, the doctrine of set-off and the doctrine of equitable recoupment. As refund litigation doctrines, set-off and equitable recoupment suffer from the common limitation that they are defensive only. They may operate to reduce or eliminate a refund sought by a taxpayer for an open tax period, but they provide no affirmative basis on which the government can assert a deficiency.[178]

Moreover, even when the government is in a defensive posture in a refund action, set-off and equitable recoupment often are less than fully satisfactory. Set-off customarily is thought to be limited to situations involving the same tax, the same taxpayer and the same tax period.[179] Thus, it cannot reach the multi-year effects typical of inconsistency cases.

Equitable recoupment may reach different kinds of tax, different, but related, taxpayers[180] and different tax periods, but it has two serious limitations. First, as previously noted, the prevalent view is that equitable recoupment is displaced by the statute of limitations mitigation provisions whenever the particular case is within the general ambit of those provisions even if mitigation is not possible for failure of one or another of the technical elements. Second, equitable recoupment operates only when the taxes to be recouped arose from the same taxable event or transaction that gave rise to the overpayment sought to be refunded,

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175 See, e.g., Crosley Corp. v. United States, 229 F.2d 376, 378-79 (6th Cir. 1956).

176 See text accompanying notes 90-100.

177 Another judicial anti-inconsistency device, the doctrine of judicial estoppel, was not ancestral to the duty of consistency although it sometimes is confused with it, see, e.g., DiLeo v. Commissioner, 58 T.C.M. (CCH) 304, 310 (1989). Judicial estoppel will operate in few cases. Under that doctrine, a party "who has obtained relief from an adversary by asserting and offering proof to support one position may not be heard later in the same court to contradict himself in an effort to establish against the same adversary a second claim inconsistent with his earlier contention." Scarano v. Central R.R., 203 F.2d 510, 513 (3d Cir. 1953). Thus, as pertinent here, judicial estoppel would be available only if the prior representation had been made in a proceeding in the same court hearing the later case.

178 E.g., Stone v. White, 301 U.S. 532, 539, modified, 302 U.S. 639 (1937); O'Brien v. United States, 766 F.2d 1038, 1049 (7th Cir. 1985).

179 See, e.g., Lewis v. Reynolds, 284 U.S. 281, 282-83 (1932); Patterson v. Belcher, 302 F.2d 289, 295 (5th Cir. 1962).

180 It is not settled which relationships suffice to allow application of equitable recoupment to recover taxes owed by one taxpayer out of taxes otherwise refundable to another taxpayer. See generally *Stone*, 301 U.S. at 535-38; Edmonds v. Commissioner, 90 F.2d 14, 17 (9th Cir.), cert. denied, 302 U.S. 713 (1937); Hufbauer v. United States, 297 F. Supp. 247, 250-52 (S.D. Cal. 1968); Kramer v. United States, 406 F.2d 1363, 1371 (Ct. Cl. 1969).

a requirement that usually is construed narrowly.[181] Since a taxpayer inconsistency case typically involves related events or transactions, rather than a single event or transaction, this rule sharply reduces the utility of equitable recoupment as a means of curbing or redressing such inconsistency.[182]

One final anti-inconsistency device, the tax benefit rule,[183] will overlap with the duty of consistency in some cases. Although the tax benefit rule is a useful weapon in the anti-inconsistency arsenal, it is not sufficient. First, its parameters are still uncertain.[184]

Second, the tax benefit rule is triggered only by cases in which the first operative event is a deduction or a credit taken for an item. Many inconsistency cases—for example, double exclusion of income cases—are not marked by that event, so cannot be reached by the tax benefit rule.[185] Third, the Tax Court and some other courts have held that the tax benefit rule does not operate if the deduction was legally improper when taken in the now-closed period.[186] Of course, this would leave a yawning chasm for inconsistency, and one in which, incongruously, the worst sort of inconsistency—inconsistency shielding a clearly improper tax underpayment—would be the one least open to correction. The Tax Court has enlisted the duty of consistency to avoid these results, holding that the duty, if applicable, vitiates the erroneous deduction exception to the

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[181] See, e.g., Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 302-03 (1946); Minskoff v. United States, 349 F. Supp. 1146, 1148-50 (S.D.N.Y. 1972), aff'd per curiam, 490 F.2d 1283 (2d Cir. 1974); Missouri Pub. Serv. Co. v. United States, 245 F. Supp. 954, 962 (W.D. Mo. 1965), aff'd as to other issues, 370 F.2d 971 (8th Cir. 1967).

[182] See, e.g., Ford v. United States, 276 F.2d 17, 33 (Ct. Cl. 1960).

[183] Originally a judicial doctrine like the duty of consistency, the tax benefit rule has been limited, and, except as so limited, has been implicitly approved, by § 111 and regulations promulgated thereunder.

[184] The tax benefit rule has two aspects. Originally, the rule required the inclusion in gross income of items which a taxpayer had deducted in a prior tax year and then recovered in a subsequent year. See, e.g., Dobson v. Commissioner, 320 U.S. 489, 502-03 (1943). The other aspect of the rule emanates from the Supreme Court's decision in Hillsboro Nat'l Bank v. Commissioner, 460 U.S. 370 (1983) (consolidated with United States v. Bliss Dairy, Inc.). The court found that a recovery is not always essential if a subsequent event was fundamentally inconsistent with the prior deduction. "Fundamental inconsistency" means that "if [the] event had occurred within the same taxable year [as the deduction was taken], it would have foreclosed the deduction." Id. at 383-84.

It is not yet clear how large a role *Hillsboro National Bank* will play. In that decision, the Supreme Court itself appeared to urge caution in application of the broader aspect of the tax benefit rule. Id. at 383. Whether for this reason or because of their own hesitancy, the lower courts have not pushed *Hillsboro National Bank* aggressively. See, e.g., Rojas v. Commissioner, 90 T.C. 1090 (1988), aff'd, 901 F.2d 810 (9th Cir. 1990).

[185] For a suggestion that the tax benefit rule should apply more broadly, see Del Cotto & Joyce, note 60.

[186] See text accompanying notes 43-46.

tax benefit rule.[187] There can be no clearer demonstration that the tax benefit rule cannot do the anti-inconsistency job alone.

2. Combining the Duty of Consistency with Other Judicial Rules

When the duty of consistency and some other judicial doctrine both apply to a given case, should one preempt the other? This question has been little discussed in the case law. In one of the few exceptions, the Sixth Circuit rejected the government's duty of consistency argument, concluding that the duty of consistency should not apply because the government had available to it a remedy under the doctrine of equitable recoupment.[188] The court made no attempt to propound a comprehensible theory as to why the government should be required to proceed under equitable recoupment rather than under the duty of consistency, assuming that both doctrines applied to the case.

This article rejects this approach. When two or more judicial doctrines of correction apply to a case, the government should be free to proceed under any or all of them. The availability of the duty of consistency should not prevent the government from asserting instead, or in addition, any other applicable judicial doctrine. Furthermore, the availability of another judicial doctrine should not prevent the government from asserting the duty of consistency.

The above conclusion is based on the fact that, in contrast to the considerations that allow the statutory mitigation provisions to preempt when applicable, there is no principle that argues with any particular force for preferring one judicial rule to another. Since all the available doctrines are basically judge made, considerations of comity do not operate with great force.[189] Moreover, as discussed above, concerns of excessive Service discretion, unpredictability, lack of uniformity and distortion of correct taxable income weigh heavily in the duty of consistency versus mitigation context. Because all the judicial remedies operate on the open tax period and not the closed one, these concerns are irrelevant in the duty of consistency versus other judicial doctrines context.

Thus, there should be no requirement that any judicial doctrine of correction necessarily be used instead of any other such doctrine. However, although not required, it would not be surprising to see the duty of consistency emerge in actual practice as a principal remedy in this area. The duty of consistency is among the most flexible of the remedies, and its

[187] E.g., Mayfair Minerals, Inc. v. Commissioner, 56 T.C. 82, aff'd per curiam, 456 F.2d 622 (5th Cir. 1972).

[188] Crosley Corp. v. United States, 229 F.2d 376, 381 (6th Cir. 1956), rev'g 55-1 U.S.T.C. ¶ 9124 (S.D. Ohio 1954).

[189] The partial codification of the tax benefit rule is less than overwhelming since the main thrust of § 111 is its exclusionary aspect, not its inclusionary aspect.

ability to reach a wide variety of inconsistencies is important. Precisely because it is not bound by many of the limitations described above with respect to alternative judicial doctrines, the duty of consistency is likely in the final analysis to preponderate over most of the alternative doctrines.

Such a development would have a wholesome side effect: It would contribute to procedural simplification of the tax law. Two examples highlight this possibility. First, there will be few, if any, cases to which the doctrine of election would apply to which the duty of consistency would not also apply. Hence, the former can be largely subsumed in the latter. Second, the Tax Court and the parties appearing before it now are forced to undergo an exhausting drill in erroneous deduction tax benefit rule cases. They must first ascertain whether the usual requirements of the tax benefit rule are satisfied. Subsequently, they must determine whether the erroneous deduction exception applies, and whether the duty of consistency applies to vitiate that exception. The presentation and decision of these cases would be simplified considerably were the cases analyzed under the duty of consistency from the start rather than under the tax benefit rule. The court and the parties could then begin and often end with the last of the above analytical stages.

VI. Conclusion

Ralph Waldo Emerson once observed:

> A foolish consistency is the hobgoblin of little minds, adored by little statesmen, and philosophers and divines. With consistency a great soul has simply nothing to do . . . . Speak what you think today in hard words and tomorrow speak what tomorrow thinks in hard words again, though it contradict everything you said today.[190]

Whatever the utility of this advice as a precept for personal development and social discourse, demanding positional consistency from taxpayers is neither foolish nor a fetish of the petty. This article has suggested a number of doctrinal revisions and clarifications to maximize the contribution of the taxpayer duty of consistency to the tax system and to help harmonize it with other judicial and statutory devices.

The unifying elements of the proposed reformulation are both philosophical and procedural. Philosophically, it is time to change the context within which consistency decisions are made from a moral clash focusing on the respective culpabilities of the two parties before the court into a

[190] Ralph W. Emerson, Self-Reliance, in Essays: First Series (1841).

policy-based deliberation pivoting on the effects that the doctrinal alternatives have on key tax system values. Procedurally, the needed changes are best achieved through splitting the burden of proof, requiring the Service to prove the elements of its prima facie case and, after such elements have been established, requiring the taxpayer to bear the burden as to any special defenses against a consistency adjustment. Choices about who bears the burden as to each item again should be made by reference to concrete policy values and the objectives of the taxpayer duty of consistency.