Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies

Arthur W. Andrews*

Introduction

There are three potential forms in which to litigate the merits of a controversy involving federal income, gift, estate and certain excise taxes. The sole prepayment forum, where a taxpayer may litigate the merits prior to being required to pay the tax in issue, is the United States Tax Court.[1] In contrast, there are two alternative postpayment forums where the taxpayer may litigate a controversy only after first paying the tax in full,[2] either the United States Claims Court[3] or the appropriate federal district court.[4] The postpayment tribunals, otherwise known as refund suit forums, are also the only courts in which to litigate the merits of controversies involving taxes not within the jurisdiction of the Tax Court.[5] Assuming that the issue involves a type of tax over which the Tax Court has jurisdiction, and that the

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* Professor of Law, University of Arizona. B.A. 1959, University of Iowa; L.L.B., 1963, LL.M. (in Taxation), 1964, New York University. Member of the Arizona, Iowa and New York bars.

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1. Internal Revenue Code of 1986 [hereinafter I.R.C.], §§ 7442, 6211, 6212, 6213, 6214, 6215.

2. Full payment is generally a jurisdictional prerequisite to maintaining a refund suit in either of the alternative postpayment forums. Flora v. United States, 362 U.S. 145 (1960); Green v. United States, 44 A.F.T.R.2d (P-H) 79-5168 (Ct. Cl. 1979). As to whether this requires payment of the interest as well, *compare* The Kell-Strom Tool Co. v. United States, 205 F. Supp. 190 (D. Conn. 1962) (no) *with* Arnold v. United States, 50 A.F.T.R.2d (P-H) 82-6167 (N.D. Ohio 1982) (yes). *See* Flora v. United States, 362 U.S. at 171 n.37(d); Walker v. United States, 333 F.2d 768, 771 (9th Cir. 1964), *cert. denied*, 380 U.S. 926, *reh'g denied*, 380 U.S. 989, 382 U.S. 911 (1965). Where divisible taxes are involved, payment of the tax on only a single transaction or event will satisfy the full payment rule. Flora v. United States, 362 U.S. at 171 n.37, 175 n.38. *See* Steele v. United States, 280 F.2d 89 (8th Cir. 1960) (now essentially codified in I.R.C. § 6672(b)). *See generally* M. Garbis & S. Struntz, Tax Procedure and Tax Fraud: Cases and Materials 315-17 (1982).

3. 28 U.S. § 1491(a)(1) (1982).

4. *Id.* § 1346(a)(1). As to which federal district court is appropriate, *see id.* § 1402(a).

5. For example, employment and wagering taxes are not within the jurisdiction of the Tax Court. *See* S. Rep. No. 938, 94th Cong., 2d Sess. at 360, 361 (1976); H.R. Rep. No. 658, 94th Cong., 1st Sess. at 299, 300 (1975); *In re* Cornell, 24 A.F.T.F.2d (P-H) 69-5632 (D. Nev. 1969).

taxpayer in question possesses the means to pay fully the asserted tax deficiency, then the taxpayer has true freedom of choice as to which of these three forums to utilize in pursuing his case.

The statutes of limitation with which this article is concerned are those applicable to the assessment and collection of a deficiency in tax[6] by the government[7] and to the obtaining of a refund of an overpayment of tax by the taxpayer.[8] Insofar as the government is concerned, it will ordinarily

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6. Additions to tax for failure to timely file and pay tax under § 6651, for underpayments of estimated tax by individuals under § 6654 and by corporations under § 6655 are not generally within the jurisdiction of the United States Tax Court unless, in the case of § 6651, the addition is attributable to a deficiency in tax within the meaning of § 6211, or unless, in the case of §§ 6654 and 6655, no return is filed for the taxable year. I.R.C. § 6662(b). *See* I.R.C. § 6214(a) as amended by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1554(a), — Stat. — (1986). *See generally* Estate of Scarangella v. Commissioner, 60 T.C. 184 (1973). *But see* Estate of DiRezza v. Commissioner, 78 T.C. 19 (1982) (payment of proposed estate tax liability before issuance of statutory notice determining a § 6651(a)(1) addition to tax for late filing, but no deficiency in estate tax, did not oust the Tax Court of jurisdiction because such addition was attributable to a tax which was subject to the deficiency procedures for purposes of the identical predecessor of § 6662(b)(1)). Nor does the Tax Court have jurisdiction over the § 6652(c) fifty-percent penalty for failure to report tips. Judd v. Commissioner, 74 T.C. 651 (1980). As to issues involving interest, *see* Benson v. Commissioner, 51 T.C.M. 136 (1985).

7. Special situations exist where either an extended or no statute of limitation on assessment applies. For example, no statute of limitation applies to the filing of a false or fraudulent return, a willful attempt to evade tax and failure to file. I.R.C. § 6501(c)(1)-(3). In this regard the fraudulent failure to file followed by the following of a delinquent, non-fraudulent original return operates to invoke the normal three-year assessment statute. Bennett v. Commissioner, 30 T.C. 114 (1958); Rev. Rul. 79-178, 1979-1 C.B. 435.

An extended limitation statute of six years from the time of filing applies to an omission from the gross estate, or from the total gifts in a return period, of more than 25 percent of the gross estate or total gifts stated in the applicable federal tax return. I.R.C. § 6501(e)(2). The same six-year period applies to omissions of more than 25 percent from the gross income stated on the federal income tax return. *Id.* § 6501(e)(1)(A). In this latter case, the filing of an original, non-fraudulent return with a more-than-25-percent omission followed by an amended return with no such 25-plus-percent omission does not operate to make the normal three-year statute applicable; instead, the extended six-year provision apparently still governs. *See* Houston v. Commissioner, 38 T.C. 486 (1962). Likewise, where an amended non-fraudulent return is filed after an original fraudulent return, an assessment may be made at any time. Badaracco v. Commissioner, 104 S. Ct. 756 (1984).

There are various special limitation provisions dealing with deficiencies attributable to the carryback of such items as net operating losses, capital losses and credits, generally permitting assessment for such carryback years within the period of assessment allowable for the year giving rise to the carryback. *See* I.R.C. §§ 6501(h), (j). There are also a number of special limitation provisions outside of § 6501 sprinkled throughout the Code. *See, e.g.*, I.R.C. §§ 302(c)(2)(A) (acquisition of prohibited interest by redeemee within ten years after redemption), 1033(a)(2)(C), (D) (elective non-recognition of gain on involuntary conversion), 1034(j) (non-recognition of gain on sale of principal residence).

Finally, in addition to the 18 month period applicable to the request for prompt assessment of income taxes in the case of a decedent or his estate, the applicable assessment period may be extended by agreement. I.R.C. § 6501(c)(4). *See* I.R.C. § 6501(d). As an alternative to an extension to a specific future date, the agreement may effectively provide for an open-ended or indefinite extension, at least for what turns out to be a "reasonable" period. *See* McManus v. Commissioner, 583 F.2d 443 (9th Cir. 1978), *cert. denied*, 440 U.S. 959 (1979). For the current Internal Revenue Service policy on requesting indefinite extensions, *see* Rev. Proc. 79-22, 1979-1 C.B. 563. For indications of recent thinking of the IRS concerning under what conditions it will agree to extend the statute of limitations on assessment only as to certain issues or items (restrictive consent), *see Effective tax procedures: Liaison meetings yield hints on consents, powers of attorney, disclosures*, 56 J. TAX'N 251 (April 1982); *Shop Talk: I.R.S. states position on restricted consents*, 54 J. TAX'N 381-82 (June 1981); *Effective Tax Procedures: I.R.S. formulates "restrictive consent" policy to limit statute of limitations extensions*, 49 J. TAX'N 120 (August 1978). *See generally* Rev. Proc. 68-31, 1968-2 C.B. 917, *modified*, Rev. Proc. 77-6, 1977-1 C.B. 539; M. SALTZMAN, IRS PRACTICE AND PROCEDURE ¶ 8.06[5](c) at 8-56 to 57 (1981).

8. Special extended statutes of limitation on the filing of claims for refund, in addition to the

have only three years after the filing of the particular return to assert a deficiency.[9] The taxpayer, on the other hand, must first file a claim for refund[10] within the later of three years from the time the return was filed *or* two years from the time the tax was paid, normally.[11] Assuming such a timely filing of the claim, the taxpayer thereafter faces a further double-faceted statute of limitation applicable to the commencement of his suit for refund.[12] The taxpayer may not generally begin his suit until the expiration of six months after the date of filing the claim for refund unless the government has sooner disallowed it.[13] At the other end of the spectrum, the taxpayer may not start the suit after the expiration of two years following the date of the requisite mailing by the government of the notice of disallowance of the claim for refund.[14]

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ordinary limitations provision, are designed to deal with problems engendered by our concept of annual tax accounting. These include refunds attributable to net operating loss, capital loss and credit carrybacks, among others. *See* I.R.C. § 6511(d)(2)(A), 6511(d)(4)(A). If the statute of limitations on assessment has been extended by agreement under § 6501(c)(4), then the period for filing a claim for refund is automatically extended for six months beyond that agreement period where the agreement was made within the period for filing claim for refund. *Id.* § 6511(c)(1).

9. *Id.* § 6501(a). For suspension of the applicable assessment limitations statutes, *see generally id.* § 6503.

10. *Id.* § 7422(a).

11. *Id.* § 6511(a). If no return was filed by the taxpayer, the claim must be filed within two years from the payment date. *Id.*

12. *See id.* § 6532(a)(1).

13. Although the taxpayer is statutorily permitted to waive the requirement that the Service mail a notice of disallowance of the refund claim, the filing of such waiver before the expiration of the six-month period does not allow the taxpayer to start the refund suit *earlier* than otherwise permitted by § 6532(a)(1). Treas. Reg. § 301.6532-1(c)(4), T.D. 6172, 1956-1 C.B. 565, 595. *See* I.R.C. § 6532(a)(3) and note 14, *infra*, for the effect of the waiver on the measurement of the two year period after which suit is barred. The Service has announced, however, that where the taxpayer is filing a refund claim based solely on contested income, estate or gift tax issues in previously examined returns and does not wish to pursue an appeal within the Service, a request for immediate disallowance will be promptly granted in order to allow the earlier filing of the refund suit. *Miscellaneous Announcement 2644*, IR-1600 (Apr. 26, 1976), Mertens, *Law of Federal Income Taxation, 1976 Rulings* vol. at M.A., p. 145. As to expediting matters earlier in the administrative process, *see* I.R.C. §§ 6501(d), 2204.

14. The taxpayer is statutorily permitted to waive the requirement that the Service mail the notice of disallowance, and the effect of such waiver filing is to start the running of the two year period after which suit is barred. I.R.C. § 6532(a)(3). In the absence of such a waiver, the failure of the government to act on the claim results in the statutory period for filing suit remaining open. *See* Detroit Trust Co. v. United States, 130 F. Supp. 815 (Ct. Cl. 1955) (refund claim of 1917 income taxes filed 1923 and amended 1948 with no action taken by I.R.S. while awaiting the outcome of litigation in related matter; formal disallowance on July 27, 1951 with refund suit filed on July 24, 1953: held timely). As in the case of the assessment limitation provision, the two year period for filing suit for refund can be extended by agreement. I.R.C. § 6532(a)(2). *See id.* § 6501(c)(4). Such an agreement, to be effective, must be made before the two year period has expired. Rev. Rul. 71-57, 1971-1 C.B. 405. Ordinarily, this extension by agreement is accomplished by the execution of Form 907. *See* Rev. Rul. 76-60, 1976-1 C.B. 387. The Court of Claims has held, however, that the formal reconsideration of an already disallowed refund claim by the IRS constituted such an extension despite § 6532(a)(4). Southeast Bank of Orlando v. United States, 676 F.2d 660 (Ct. Cl. 1982).

Finally, estoppel of the government in federal tax cases, as well as in other matters, is generally rare and, to say the least, is certainly the exception and not the rule. *See* Schweiker v. Hansen, 450 U.S. 785 (1981); Automobile Club of Mich. v. Commissioner, 353 U.S. 180 (1957); Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 385 (1947) ("Men must turn square corners when they deal with the government.") There are, however, at least two cases involving the measurement of this two year period where estoppel of the government has resulted. Thus, despite the earlier filing of a taxpayer waiver under § 6532(a)(3), the Second Circuit held that the two year period commenced only from the later inadvertent mailing of a notice of disallowance, on the basis of estoppel. Miller v. United States, 500 F.2d 1007 (2d Cir. 1974). Likewise, although the statute provides that any reconsidera-

From an early date the judicially created doctrine of equitable recoupment has permitted both the government and the taxpayer to avoid the bar of the applicable tax statute of limitation in certain restricted circumstances. The Article first traces the history of that doctrine in the Supreme Court which both established it and, then, subsequently limited its applicability both substantively and also as to the forum in which it could be raised. Its relationship to another judicial doctrine negating the tax limitation bar, as well as to the statutory migration provisions of the Code, is then set out. Thereafter, this Article summarizes the areas where equitable recoupment may apply today and its chief procedural features, with emphasis upon the proper method for invoking the doctrine in the adversarial context.

The Article then turns to a specific consideration of the area in which the doctrine has its principal modern-day thrust. In this arena, involving two different types of taxes at least one of which is not income tax, a conflict exists between the circuit courts of appeal as to whether equitable recoupment should apply where the two taxes are statutorily interrelated. This is the so-called "two tax effect" which describes the interplay between two taxes being imposed on essentially the same taxpayer.[15] For illustrative purposes, the Article focuses on one such situation precisely dealt with by the conflicting cases: where a pre-death federal income tax liability of the decedent is deductible by the estate for federal estate tax purposes.

It is in this setting, at least on the taxpayer's side of equitable recoupment, that the choice of the appropriate forum becomes crucial. Assuming that the open claim (not barred by the applicable tax limitation statute) concerns the type of tax over which the Tax Court may exercise jurisdiction, we shall see that, of the three forums potentially available, only one will likely permit the taxpayer to equitably recoup the barred claim.

Having thus briefly set the stage, it is now necessary to gain a basic understanding of equitable recoupment by considering the Supreme Court cases which established it in the field of federal taxation and set its parameters.

EQUITABLE RECOUPMENT IN THE SUPREME COURT

Although the United States Supreme Court established the applicability of the doctrine of equitable recoupment in federal taxation over half a century ago, the Court has only dealt with that topic in a substantive way in a total of four cases, the last instance occurring in 1946. Since that time the further development and refinement of the doctrine have been left to the lower courts and the Internal Revenue Service through their application of the Supreme Court's guidelines and as complicated by the passage of the Code provisions for the mitigation of the effect of the statutes of limitation in

tion or action by the government after mailing the disallowance notice does not extend the two year period, the Court of Claims has held that estoppel prevented the measuring of this period from a prior notice when the Service subsequently mailed a second notice (for the purpose of correcting its earlier use of an erroneous refund claim filing date). Heath v. United States, 219 Ct. Cl. 582 (1979). *See* Southeast Bank of Orlando v. United States, 676 F.2d 660 (Ct. Cl. 1982).

15. *See* Wilmington Trust Co. v. United States, 610 F.2d 703, 714 (Ct. Cl. 1979).

1938.[16]

Bull v. United States

The doctrine apparently had its genesis in federal tax matters in 1935. In *Bull v. United States*,[17] a decedent-partner died on February 13, 1920, and his estate received, pursuant to its election to continue in the partnership according to the terms of the partnership agreement, the sum of approximately $212,000 constituting its share of partnership profits earned subsequent to the decedent's death.[18] For federal estate tax purposes, the Commissioner in 1921 required the executor to include this $212,000 in the gross estate on the then erroneous theory that it constituted corpus of the estate, and the executor paid the resulting increase in tax in the amount of about $42,000. Subsequently, in 1925, the Commissioner asserted a deficiency in federal income tax against the estate for the period February 13, 1920 to December 31, 1920 on the correct theory that this same sum[19] was income to the estate. The Board of Tax Appeals thereafter sustained the Commissioner's determination, and the executor paid this income tax deficiency of some $63,000 in April 1928. Later, in mid-1928, the executor filed a claim for refund of this income tax payment and commenced a suit for refund in the Court of Claims after the claim was denied.[20]

16. *See generally* Maguire, Surrey & Traynor, *Section 820 of the Revenue Act of 1938* (part 1), 48 YALE L.J. 509 (1939) and (part 2), 48 YALE L.J. 719 (1939).

17. 295 U.S. 247 (1935).

18. Of this total sum, about $200,000 was paid to the estate in the period from the date of the decedent's death to December 31, 1920. The remaining $12,000 was paid in early 1921.

19. The deficiency assertion was actually based on that which the estate had received during this short taxable period, some $200,000. *See* note 18, *supra*.

20. The procedure followed here in which the executor first litigated the income tax deficiency before the Board of Tax Appeals, lost, paid the income tax deficiency, and then subsequently sued for refund of that same income tax payment in the Court of Claims is, at first blush, confusing in view of the ordinary concepts of finality and res judicata. However, prior to the enactment of the Revenue Act of 1926, a taxpayer was allowed to sue for a refund after payment of a deficiency determined by the Board of Tax Appeals because there was then no direct review of Board decisions. Accordingly, review was obtainable by a separate action in court for refund after payment of a deficiency determined by the Board of Tax Appeals because there was then no direct review of Board decisions. Accordingly, review was obtainable by a separate action in court for refund following payment of the tax. Ferguson, *Jurisdictional Problems in Federal Tax Controversies*, 48 IOWA L. REV. 312, 350-51 (1963). The Revenue Act of 1926 substituted direct judicial review of the Board's decisions in the circuit courts of appeals. Revenue Act of 1926, ch. 27, § 1001(a), 44 Stat. 109. At the same time the 1926 Act gave finality to decisions of the Board (as appealable to the circuit courts) by providing generally that, after the taxpayer has filed a timely petition with the Board, he may not thereafter institute a new suit in another court for the refund of the same tax. *Id.*, § 284(d), 44 Stat. 67. But where, as in *Bull*, the executor filed his petition with the Board in 1925 before the 1926 enactment and the Board decided the case after its enactment, the pre-1926 law still applied. *See* Old Colony Trust Co. v. Commissioner, 279 U.S. 716, 721-22, 725-28 (1929).

The present version of this finality provision of the 1926 Act is § 6512(a) of the Internal Revenue Code of 1986. Thus, the precise procedure that availed the executor in *Bull* would no longer be possible because the Tax Court decision would have finality as to the tax in question for the year in question and recovery of that income tax payment by suit for refund in another court would be barred by section 6512(a). See Elbert v. Johnson, 164 F.2d 421 (2d Cir. 1947); Holzer v. United States, 250 F. Supp. 875 (E.D. Wis. 1966), *aff'd per curiam*, 367 F.2d 822 (7th Cir. 1966); Kojes v. United States, 241 F. Supp. 762 (E.D.N.Y. 1965). The conclusion is that equitable recoupment is not available in those cases where the overpayment of tax that is barred from recovery by the applicable statute of limitation is sought to be equitably recouped against a tax deficiency payment, the recovery of which is itself barred by § 6512(a). *Id.* *See infra* text accompanying notes 90-109.

One of the alternative theories for recovery was that, if the post-death partnership profits were properly income to the estate, then the United States should have credited against the $63,000 income tax liability attributable to it the $42,000 federal estate tax overpayment resulting from its improperly being treated as corpus of the estate. After first determining that the post-death partnership profits were correctly income to the estate and taxable as such, the Court of Claims denied recovery on this alternative theory for the reason that any refund of the federal estate tax overpayment would be barred by the statute of limitation.[21]

Holding that the estate's share of post-death partnership profits was properly taxable as income to the estate and that what was income could not, at least in this particular case, at the same time also be estate corpus, the Supreme Court determined that the Commissioner had erroneously and inconsistently included these profits in the gross estate for federal estate tax purposes, thereby subjecting these same profits to two different taxes.[22] Although it likewise indicated that recovery of the $42,000 estate tax overpayment was itself directly barred by the statute of limitation,[23] the Supreme Court concluded that the estate was nonetheless entitled to have this barred overpayment credited against the $63,000 income tax liability resulting in a refund of such previously paid *income* tax (in an amount equivalent to the barred estate tax overpayment).[24] The estate's timely income tax refund claim had been brought after payment in response to the government's timely assertion of the income tax deficiency. The theory of equitable recoupment supported recovery.[25]

The Court, in explaining equitable recoupment and its applicability to the facts of this case, stated:

> . . . [the] [g]overnment brought a new [income tax] proceeding arising out of the *same transaction* [—the receipt of post-death partnership profits—] involved in the earlier [estate tax] proceeding. . . . The taxpayer opposed payment [of the income tax] . . . by demanding recoupment of the amount mistakenly collected as estate tax and wrongfully retained. . . . While here the money was taken through mistake without any element of fraud, the unjust retention is immoral and amounts in law to a fraud on the taxpayer's rights. . . . A claim for recovery of money so held may not only be the subject of a suit in the Court of Claims . . . but may be used by way of recoupment and credit in an action by the United States arising out of the *same transaction*. . . . If the claim for income tax deficiency had been the subject of a suit, any counter demand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained notwithstanding the statutes of limitation had barred an independent suit against the Government therefor. This is because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred

21. 295 U.S. 247, 253-54, 258 (1935).
22. *Id.* at 254-58.
23. *Id.* at 258.
24. *Id.* at 263.
25. *Id.* at 261-62.

by the statute of limitations so long as the main action itself is timely.[26]

The talismanic key, then, to the successful invocation of equitable recoupment in *Bull* was the existence of the single transaction—the receipt of post-death partnership profits—out of which arose both the main claim of the government for the income tax deficiency and the claim of the taxpayer for the estate tax overpayment. As a direct consequence of that magical catalyst in *Bull*, the taxpayer was permitted to use a barred overpayment of one tax to recover part of a payment on an open deficiency of another tax, thereby effectively avoiding the statute of limitation with respect to such barred overpayment.[27]

Stone v. White

Two years later the Supreme Court had its second occasion to deal with the use of this doctrine to avoid the limitations bar—this time by the government—in *Stone v. White*.[28] In *Stone*, the decedent established a testamentary trust the terms of which required the trustee to pay over the net income therefrom to the decedent's wife as sole beneficiary, the wife having elected to take under the decedent's will in lieu of her dower or statutory interest. The wife as sole beneficiary had not included any of the income distributed to her by the trust in her 1928 federal income tax return. This had been done, apparently in good faith, on the theory that by electing to take under the will the wife had purchased an annuity (represented by the trust income payments) which was not taxable to her until the payments received exceeded the value of the surrendered dower or statutory interest. This theory was supported by several court of appeals decisions[29] which led the Commissioner to timely assert an income tax deficiency against the trust on the basis

26. *Id.*

27. *Accord*, Darcy v. United States, 15 F. Supp. 251 (Ct. Cl. 1936). It is also worthwhile to note that the executor in *Bull* might have been deemed somewhat lacking in diligence by not timely filing a claim for refund of federal estate tax when it first became known that the Commissioner would seek to subject the post-death partnership profits in the hands of the estate to the income tax. Bull died on February 13, 1920 and, consequently, the estate tax provisions of the 1918 revenue act were implicated as it became law on February 24, 1919 and applied to persons dying after its passage. *See* Revenue Act of 1918, Pub. L. No. 254, ch. 18, § 401, 40 Stat. 1057, 1096. The 1921 revenue act provided the applicable statute of limitation on making claims for refund. The taxpayer had to file the claim within a four year period measured from the date of payment. The 1921 revenue act provided the applicable statute of limitations was to be given retroactive effect to claims for refund under, *inter alia*, the 1918 revenue act. Revenue Act of 1921, Pub. L. No. 98, ch. 136, § 1316, 42 Stat. (part 1) 314. This four year period from the payment date for the filing of refund claims for estate tax was continued in both the 1924 and 1926 revenue acts. Revenue Act of 1924, Pub. L. No. 176, ch. 234, § 1012, 43 Stat. (part 1) 342; Revenue Act of 1926, Pub. L. 20, ch. 27, § 1112, 44 Stat. (pt. 2) 115. *See* Bull v. United States, 295 U.S. 247, 258 n.7 (1935). The executor paid the federal estate tax on the post-death partnership profits in full in August 1921. *Bull*, 295 U.S. at 258 (1935). As the Commissioner notified the executor of the asserted income tax deficiency in July, 1925, the executor had up to one month in which to file an estate tax refund claim in timely fashion under the four-year-from-payment-date period. Despite the equitable nature of recoupment, the executor's seeming lack of diligence was not enough to prevent its application by the Supreme Court in *Bull*. This factor which bears upon the "equitableness" of equitable recoupment has not escaped the attention of the lower courts. *See* United States v. Bowcut, 287 F.2d 654, 656-57 (9th Cir. 1961); United States v. Herring, 240 F.2d 225, 228 (4th Cir. 1957).

28. 301 U.S. 532 (1937).

29. Allen v. Brandeis, 29 F.2d 363 (8th Cir. 1928); United States v. Bolster, 26 F.2d 760 (1st Cir. 1928); Warner v. Walsh, 15 F.2d 367 (2d Cir. 1926).

that it was not entitled to any distributions deduction attributable to such a "purchase."[30] The trustees paid this deficiency from the trust income after the statute of limitation barred the collection of any deficiency from the beneficiary for 1928. In the meanwhile an intervening decision of the Supreme Court on the substantive merits in *Helvering v. Butterworth*[31] held that the wife's election to take under the will did not make her a "purchaser" nor any less a beneficiary. Consequently, the trust was entitled to the distributions deduction for the trust income payments which were, thus, taxable to the wife.

After the trustees in *Stone* timely instituted a suit for refund of the income tax deficiency payment erroneously collected from the trust, the government defended on the ground that it should be allowed to use the greater deficiency that the beneficiary owed (despite the fact that direct collection of it was now barred) to deny recovery by the trust of its lesser overpayment in view of the fact that any such recovery by the trust "would inure to the advantage of the beneficiary."[32] To the contrary, the trustees first argued that the trust and beneficiary were two distinct and different taxpayers, and this separate taxable entity status prevented the one taxpayer's liability from being offset with a different taxpayer's overpayment.[33]

Although acknowledging the separate status of trust and beneficiary for many purposes,[34] the Supreme Court rejected that status as controlling in this case for equitable reasons in view of the essential identity of interest between the two here. The Court first noted that a trustee's right to recover in a suit brought in a court with equity powers and in the name of the trustee alone could be "diminished by reference to the fact that the suit . . . is for the benefit of the . . . [beneficiary]."[35] The Court then said:

> In the present case a single tax was due upon the particular income . . . and [the trustee's] . . . demand arises from the circumstance that the tax was paid from the income by the trustees when it should have been paid by the beneficiary. . . . [But] . . . any recovery in this action will be [to the advantage of] . . . the beneficiary [under the terms of the testamentary trust], and will deprive the government of a tax to which it is justly entitled and enable the beneficiary to escape a tax she should have paid. . . .
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> Equitable conceptions of justice compel the conclusion that the retention of the tax money would not result in any unjust enrichment of the government . . . . No injustice is done to the trustees or the beneficiary by withholding from the trustees money which in equity is the beneficiary's and which the government received in payment of a tax which was hers to pay. A single error on the part of the taxing authorities . . . has caused both the underassessment of one taxpayer and the overassessment of the other. But the error has not increased the tax burden of either, for whether the tax is paid by one or the

30. *See* Helvering v. Butterworth, 290 U.S. 365, 368-69 (1933).
31. *Id.* at 370.
32. 301 U.S. 532, 534 (1937).
33. *Id.* at 535.
34. *Id.* at 535-36.
35. *Id.* at 536.

other, its source is the fund which should pay the tax, and only the equitable owner of the fund is ultimately burdened.[36]

The trustees also contended that if the government's position were sustained and recovery by the trustees denied, certain provisions of the 1928 revenue act would be violated. Section 607 provided that any tax which is assessed or paid after the applicable statute of limitation had expired would automatically be considered an "overpayment."[37] Section 609(a) then stated that any *credit* against a tax liability for a given year would be void if any *payment* in respect of such liability would be an "overpayment" under section 607.[38] The trustees maintained that sections 607 and 609(a), taken together, prohibited the government from crediting an overpayment against a barred deficiency.[39] Therefore, these sections would be violated if the trust's open overpayment were credited against the beneficiary's barred deficiency in order to deny any refund to the trust.

The Court, however, summarily dismissed this contention apparently on the basis that section 607 was not properly invoked. That was so because the government's assessment of a deficiency against the trust, although erroneous, had been timely so that no "overpayment" had occurred within the meaning of that section. Therefore, section 609(a) was not applicable.[40]

Finally, the trustees argued that, in any event, the government was precluded from denying recovery to the trust by the general statute of limitation on assessment of a deficiency which barred any proceeding in court to collect the tax after its expiration.[41] In rejecting this argument, the Court stated:

> The statutory bar to the right of action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment, why petitioners ought not to recover.
>
> Here the defense is not a counter demand on petitioners, but a denial of their equitable right to undo a payment which . . . resulted in no unjust enrichment to the government, and in no injury to petitioners or their beneficiary. The government, by retaining the tax paid by the trustees, is not reviving a stale claim. Its defense, which inheres in the cause of action, is comparable to an equitable recoupment or diminution of petitioners' right to recover. 'Such a defense is never barred by the statute of limitations so long as the main action itself is timely.' *Bull v. United States*. . . .[42]

Accordingly, the Court allowed the government to equitably recoup the

36. *Id.* at 535-36.

37. *See* Revenue Act of 1928, ch. 852, § 607, 45 Stat. 874. Section 607 is the substantially identical predecessor of the current Code provisions. *See* I.R.C. §§ 6401(a), 6402(a).

38. *See* Revenue Act of 1928, ch. 852, § 609(a), 45 Stat. 875. Section 609(a) is the substantially identical predecessor of the current Code provision. *See* I.R.C. § 6514(b).

39. Companion provisions in the 1928 Act, applicable to the taxpayer, prevented the taxpayer from utilizing a barred overpayment against an open deficiency. *See* Revenue Act of 1928, ch. 852, §§ 608, 609(b), 45 Stat. 874-75. These sections are the substantially identical predecessors of the current Code provision. *See* I.R.C. § 6514(a).

40. 301 U.S. 532, 538 (1937).

41. *Id.*

42. *Id.* at 538-39.

greater barred deficiency of the beneficiary against the lesser open overpayment of the trust in order to deny any refund to the trustees.[43]

Thus, it is fair to say that *Stone v. White* expanded the scope of equitable recoupment to reach situations involving different taxpayers where such an identity of interest existed between the two that the recovery of an open overpayment by one would inure to the sole benefit of the other with the barred deficiency. *Stone* also extended the doctrine by making it available to the government as a defense to a refund suit. But *Stone* was akin to *Bull* in that both involved a single item or transaction: in *Bull*, the receipt of post-death partnership earnings subjected to two different taxes; and in *Stone*, certain income, where the dispute centered on the identity of the correct taxpayer. Moreover, the two cases were alike as to the inconsistent treatment aspect viewed from the perspective of the party against whom the doctrine is invoked, if the actions of the trust and the beneficiary in *Stone* can be taken together due to their essential identity of interest. Thus, in *Bull* the government first asserted an estate tax liability on the theory that the item was corpus of the estate and then asserted an income tax liability on the inconsistent theory that it was, instead, income of the estate. Likewise, in *Stone* the beneficiary had not included the income payment in her gross income on the theory that they were not taxable to her and the trust had treated such amounts as similarly not taxable to it.

McEachern v. Rose

A bare five months after *Stone*, and to the surprise of many, the Court appeared to relegate the doctrine of equitable recoupment in federal taxation to seeming insignificance[44] in *McEachern v. Rose*.[45] In that case, the decedent made an *inter vivos* sale of stock in 1924, the terms of which required the purchaser to make nine future annual payments of equal amounts commencing in 1925, and the decedent had elected to report his gain utilizing the installment method. After the decedent died in 1928, his administrator in effect continued to report the gain in a similar manner on the estate's income tax return for the years 1928 through 1931 inclusive.

This treatment by the administrator was, however, improper under the then-applicable law which essentially required the remaining unreported gain (measured by the fair market value of the purchaser's installment obligations over the seller's unrecovered cost) to be fully included in income in the year of death—1928.[46] Consequently, there was a greater income tax

43. For equitable recoupment by the government of a barred income tax deficiency of a trust against the open overpayment by the beneficiary, *see* Bull v. Kavanagh, 118 F.2d 315, 321-22 (6th Cir. 1941) (sole beneficiary of an alleged grantor-type trust erroneously overpaid income taxes for the years 1931-35 on all trust income, accumulated and distributed, in response to the government's incorrect contention that the sole beneficiary was actually the grantor. Held, the government could diminish the refund otherwise due the sole beneficiary by the income tax deficiencies of the trust).

44. *See, e.g.*, Twitchco, Inc. v. United States, 348 F. Supp. 330, 336 (N.D. Ala. 1972); Note, *Estoppel and Recoupment in Federal Taxation after the Revenue Act of 1938: The Effect of Section 609 of the Revenue Act of 1928*, 52 HARV. L. REV. 496, 500-02 (1939).

45. 302 U.S. 56 (1937).

46. *Id.* at 57-58. Under the present law, the estate of the decedent could generally continue the installment method of reporting. I.R.C. §§ 453(B)(c), 691(a)(4). *See id.* § 1014(c).

deficiency for 1928 and lesser total combined income tax overpayments for the years 1929, 1930 and 1931 when no installment gain should have been reported. The overpayments for 1930 and 1931 had been made by the administrator at a time when the statute of limitations barred the collection of the deficiency for 1928. Although the 1929 overpayment had been made before the statute had run on 1928, both the claim for refund and the determination of the fact and amount of the overpayment by the Service was filed and made, respectively, after the statute had expired.[47]

Despite the conceded applicability of the statute of limitation to the 1928 deficiency, the government contended that it should nonetheless be entitled to use the greater barred 1928 deficiency to deny any refund of the lesser open 1929, 1930 and 1931 overpayments under the equitable principles of *Stone v. White*.[48] The Court, however, dismissed this contention on the ground that it was statutorily prohibited by sections 607 and 609(a) of the Revenue Act of 1928.[49] The Court, in allowing recovery by the taxpayer, held that where the actual overpayments for 1930 and 1931 had been made after the 1928 deficiency became barred, these sections clearly precluded the government from crediting such open overpayments against the barred deficiency.[50] Likewise, the government was subject to the same disability as to the 1929 open overpayment because, even though the taxpayer had made it while 1928 was still open, at the time the Service had determined its existence so that the crediting of it might otherwise occur, 1928 had become closed.[51] The Court carefully distinguished *Stone v. White* on the basis that the government's assessment of the deficiency against the trustees, although erroneous, had not been barred by limitation so that sections 607 and 609(a) did not apply.[52]

Concluding that equity should not override these statutory provisions in this case, the Court said:

> We may assume that, in the circumstances, equitable principles would preclude recovery in the absence of any statutory provision requiring a different result. But Congress has set limits to the extent to which courts might otherwise go in curtailing a recovery of overpayments of taxes because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him.[53]

Taking *McEachern* at face and without benefit of hindsight, it would appear that the Supreme Court ruled out the defense of recoupment in the situation where it would most ordinarily arise and therefore have its greatest utility: where the same taxpayer, tax and two different taxable periods were involved with the deficiency occurring in the barred period and the overpayment in the open one. Obviously, it is in just this different taxable periods

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47. 302 U.S. 56, 60, 62 (1937).
48. *Id.* at 58, 59.
49. *See supra* text accompanying notes 37-39.
50. 302 U.S. 56, 60 (1937).
51. *Id.* at 60-61.
52. *Id.* at 62-63. *See supra* text accompanying notes 37-40.
53. *Id.* at 59-60.

setting that one is most likely to encounter this barred-open dichotomy.[54] Yet the opinion specifically pointed out that the controlling legislative purpose behind the enactment of sections 607 and 609(a) was ". . . to require refund to the *taxpayer* of an overpayment, even though he has failed to pay taxes for *other* periods, whenever their collection is barred by limitation."[55]

Indeed, *McEachern* left almost the entire viability of equitable recoupment in federal taxation in grave doubt. In *Stone v. White*, where the doctrine was held to apply, the same type of tax and same taxable period but technically different taxpayers (although with an absolute identity of interest) were involved, and sections 607 and 609(a) were held inapplicable due to the government's erroneous, but timely assertion of the deficiency resulting in the open overpayment. Thus, in the post-*McEachern* sense, *Stone v. White* could be viewed as having an extremely limited continued utility. Moreover, since *Bull* had applied the doctrine initially to a case involving the same taxpayer and *different* taxes and nothing in either section 607 and 609(a) (applicable to the government) or their companion sections 608 and 609(b) (applicable to the taxpayer)[56] appeared to limit their applicability to the same type of taxes,[57] there was further reservation as to whether the *Bull* result would still hold.

Rothensies v. Electric Storage Battery Co.

There the matter rested for almost a decade until the Supreme Court spoke for the last time on the substantive applicability of equitable recoupment in 1946. In *Rothensies v. Electric Storage Battery Company*[58] the taxpayer-company paid excise taxes on the sale of its electric storage batteries from April 1919 to April 1926 based on the erroneous belief that they were subject to such tax as automobile accessories. Thereafter, in July 1926, the company filed a refund claim for the years not barred by the statute of limitation, essentially the period from mid-1922 to 1926, and ultimately received a refund of about $1,400,000 (of which some $825,000 constituted prior excise tax payments with the balance being interest) in 1935. The company did not treat the refunded tax payments as income in 1935 despite the fact that it had been deducting these same payments, with consequent substantial tax benefits to itself for federal income tax purposes[59] during the years the excise tax was still being collected.[60] Accordingly, the Commissioner timely as-

54. This is not meant to include the doctrine of set off under Lewis v. Reynolds, 284 U.S. 281 (1932). *See infra* text accompanying notes 112-23.

55. 302 U.S. 56, 62 (1937) (emphasis added).

56. *See supra* note 39.

57. The implication of these provisions was that they were not limited to the same type of tax since §§ 607 and 608 refer, respectively, to "any tax" and "an internal revenue tax" and § 609(b) refers to "any tax."

58. 329 U.S. 296 (1946).

59. Presumably the deduction of the excise taxes paid was on the theory that these were ordinary and necessary business expenses. *See* I.R.C. § 162(a). *Cf. id.* §§ 164(a) (second sentence), 275(a).

60. The refund was properly income in 1935, to the extent of the prior deductions, under the judicially created tax benefit doctrine. *See supra* note 58, at 298. This doctrine now appears in the Code as § 111. *See generally* Bittker & Kanner, *The Tax Benefit Rule*, 26 UCLA L. REV. 265 (1978).

serted a deficiency of some $230,000 in federal income tax (and excess profits tax) for 1935. The company paid the deficiency and then sued for refund after the Service rejected the refund claim.

The taxpayer asserted, successfully in both the district court and the Third Circuit Court of Appeals, that equitable recoupment should apply to permit the taxpayer to utilize the long-barred excise tax overpayments for the years 1919 to 1922 against the open income tax liability for 1935. These same 1919-1922 years had not been included in the refund claim giving rise to the 1935 income due to the limitations bar. The district court allowed the refund.[61]

On its appeal to the Third Circuit, the government made essentially two independent arguments to deny any refund for 1935. First, the government urged that sections 608 and 609(b) of the Revenue Act of 1928 statutorily prohibited the *taxpayer* from utilizing a barred overpayment against an open deficiency.[62] The government relied on *McEachern v. Rose* which had held that the *government* could not equitably recoup the greater barred 1928 deficiency against the lesser open overpayments for 1929 through 1931 in view of the statutory prohibition contained in sections 607 and 609(a) of the same act.[63] Since sections 608 and 609(b) were the concomitant provisions of that act applicable to the taxpayer, the government was, in effect, using *McEachern* quite reasonably in making its "what's sauce for the goose ought to be sauce for the gander" type of argument. The Third Circuit, however, rejected this contention, noting, among other things, that this case was like *Bull* in that the claim of the taxpayer (the 1919-1922 overpayments) arose before the passage of the 1928 act while the litigation setting up the recoupment came after the act. Since *Bull* itself had not been criticized in *McEachern* and had been cited with apparent approval in a later Supreme Court decision, the Third Circuit felt that these statutory sections should not be read, *inter alia,* as applying to the taxpayer.[64]

Second, the government argued that, in any event, equitable recoupment in favor of the taxpayer should not be allowed because it would otherwise expand the doctrine beyond that allowed by *Bull.* More specifically, *Bull* had emphasized that ". . . recoupment is in the nature of a defense arising out of some feature of the transaction upon which the . . . [main] action is grounded."[65] *Bull* had allowed recoupment where the same or single transaction, item or taxable event,[66] the receipt of the post-death partner-

61. Electric Storage Battery Co. v. Rothensies, 57 F. Supp. 731 (E.D. Pa. 1944).

62. Emphasis added. Section 608 stated that "A refund of any portion of an internal revenue tax . . . shall be considered erroneous—(a) [i]f made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed . . . ." Section 609(b) then provided that "[a] credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under § 608." Revenue Act of 1928, ch. 852, §§ 608 & 609(b), 45 Stat. 874-75. *See supra* note 39.

63. Emphasis added. *See supra* text accompanying notes 37-38.

64. Electric Storage Battery Co. v. Rothensies, 152 F.2d 521, 525 (3d Cir. 1945).

65. *See supra* text accompanying note 26.

66. These terms—the same or single transaction, item or taxable event—are used in this article interchangeably, just as the courts have used them. *See, e.g.*, Bull v. United States, 295 U.S. 247, 261 (1935) (same transaction); Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 299-300 (1946) (single transaction, single taxable event).

ship profits, had been both the basis of the government's main claim (for the open income tax deficiency) and the taxpayer's recoupment claim (the barred estate tax overpayment). Here, in contrast, the government contended that this same or single transaction attribute was not present.

Although acknowledging that ". . . the main claim and recoupment claim [in *Bull*] were more closely connected than they are here,"[67] the Third Circuit nonetheless allowed recoupment, affirming the district court. The court of appeals stated that, since ". . . recoupment is based on concepts of fairness," the same transaction element should be interpreted to mean that there be "a logical connection between the main claim and the recoupment claim." This was present here as they both "grew out of seven years of improperly assessed excise taxes on the sale of batteries."[68]

In the Supreme Court, however, the government's arguments met with a different response. The Court initially bypassed the government's first contention based upon *McEachern v. Rose*—that section 608 and 609(b) of the Revenue Act of 1928 statutorily prohibited equitable recoupment—in an enigmatic and, indeed, cursory fashion. Although acknowledging in a footnote that these statutory provisions ". . . seem to direct a result opposite to that asked by . . . [the taxpayer],"[69] the Court stated in the main body of its opinion only that "[i]t is not contended that there is any statutory warrant for allowing barred tax refund claims by way of recoupment or otherwise."[70]

Instead, said the Court in progressing to the government's second argument, "[a]uthority for it is said to be found in . . . *Bull v. United States* . . . and *Stone v. White* . . . ." The Court then proceeded to resolve the case utilizing the single transaction or taxable event element of *Bull* and *Stone* and holding that equitable recoupment should not be allowed here because this requisite had not been satisfied.[71]

The opinion pointed out that this requisite does not permit one transaction to be offset by another transaction. Instead, it only allows a *single* transaction constituting the basis of plaintiff's suit to be examined "in *all* its aspects," thereby indicating ". . . the *limited scope* given to recoupment in tax litigation."[72] The Court stated that in both cases a single transaction or taxable event constituted the basis of the plaintiff's claim and the other party's recoupment claim, such transaction or event having been subjected to two different taxes on inconsistent legal theories. In *Bull* the single transaction or taxable event was the receipt by the estate of post-death partnership profits, these profits being treated first as part of the decedent's gross estate for estate tax purposes and then later being treated as estate income for income tax purposes. In *Stone* the single transaction was the receipt of income by the trust (with distribution to the sole beneficiary), the only dispute being the correct taxable entity where a total identity of interest existed

67. 152 F.2d 521, 525 (3d Cir. 1945).

68. *Id.* at 523-24.

69. 329 U.S. 296, 299 n.1 (1946). In addition, the Supreme Court cited *McEachern v. Rose* as analogous supporting authority. *Id.*

70. *Id.* at 299.

71. *Id.* at 299-303.

72. *Id.* at 299 (emphasis added).

between the trust and beneficiary with respect thereto.[73]

Then, responding to the assertion of the Third Circuit that the single transaction element of recoupment should be liberally interpreted because it was based on fairness, the Supreme Court specifically declined to expand the doctrine beyond *Bull* and *Stone*.[74] In addressing the fairness argument, the Court noted that in specific cases the limitations bar can result in arbitrary and unjust results as to both the government and the taxpayer.[75] Nonetheless, the Court stated:

> [i]t would probably be all but intolerable . . . to have an income tax system under which there would never come a day of final settlement and which required both the taxpayer and the Government to stand ready forever . . . to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. . . . "Statutes of limitation . . . are designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded and witnesses have disappeared. The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them."[76]

Indicating that the statute of limitation, whether in favor of the government or the taxpayer, ". . . is an almost indispensable element of fairness as well as of practical administration of an income tax policy,"[77] the Court stated that its sanctioning of the scope of recoupment allowed by the Third Circuit would severely undercut the tax statute of limitation.

> In many, if not most, cases of asserted deficiency the items which occasion it relate to past years closed by statute, at least as closely as does the item involved here. . . . The same is true of items which form the basis of refund claims. Every assessment of a deficiency and each claim for a refund *would invite a search* of the taxpayer's entire history for items to recoup. . . . When this suit was brought in 1943, the claim pleaded as recoupment was for taxes collected over twenty years before and for over sixteen years barred by the statute. That claims dead so long can be resurrected under this doctrine is enough to show its menace to the statute of limitations. . . .[78]

The Supreme Court concluded by saying that "[w]e cannot approve such encroachments on the policy of the statute out of consideration for a taxpayer who *for many years failed* to file or prosecute its refund claim."[79]

It is clear that *Electric Storage Battery* involved the same taxpayer but two different taxes and different years. The Court denied recoupment because the barred overpayments of excise taxes for 1919-1922 were not closely enough connected to the open deficiency of income tax for 1935. The

73. *Id.* at 299-300.
74. *Id.* at 300-01.
75. *Id.* at 301-02.
76. *Id.* at 301.
77. *Id.*
78. *Id.* at 302-03 (emphasis added).
79. *Id.* at 303 (emphasis added).

Supreme Court, however, never stated precisely why the single transaction requisite was not met, apparently relying on the Third Circuit's statement that the claims were not as closely connected as in *Bull*.

However that may be, in the technical sense at least, the case involved two separate transactions. The barred overpayments of excise taxes for 1919-1922 arose from the erroneous treatment of sales of the storage batteries being subject to the excise tax as sales of automobile accessories. In contrast, the open income tax deficiency for 1935 arose from the taxpayer's erroneous failure to include the refunded open excise tax overpayments for 1922-1926 in gross income under the tax benefit doctrine. The erroneous failure to include income for 1935 is not the same transaction as erroneously subjecting sales of storage batteries to excise tax in 1919-1922. Moreover, and not to put too fine a point on it, neither is the *deduction* (for income tax purposes) of those erroneously paid excise taxes in the 1922-1926 technically the same transaction as the *failure to include* in gross income in the later year when the overpayment is recovered. Although in the latter situation the early year deduction and later year omission are sufficiently related for invocation of the tax benefit doctrine, they are nonetheless separate events, and both are at least one step further removed from the original erroneous early year subjection of the storage battery sales in 1919-1922 to excise tax liability.

These cases—*Bull, Stone, McEachern* and *Electric Storage Battery*—were, then, the four Supreme Court decisions which initially applied or refused to apply the doctrine of equitable recoupment in the field of federal taxation. The cases would seem to indicate that the substantive side of the doctrine includes the element that the barred claim of the party asserting it (be it the taxpayer or the government) and the open claim of the other ought to arise from the same or a single transaction, item or taxable event. It is also apparently necessary that such transaction, item or event have been the subject of inconsistent treatment.[80] And, where different taxpayers are in-

80. *See* M. SALTZMAN, *supra* note 7, ¶ 5.06[1] at 5-30. In *Bull v. United States* the Commissioner inconsistently treated the post-death partnership profits by subjecting it to both estate tax and income tax in circumstances under which such profits could only be subject to one tax, but not both. *See supra* note 22 and accompanying text. In *Stone v. White* the inconsistency was that neither the trust nor the beneficiary treated the amount in question as taxable to it when it was clearly taxable to one or the other. *See supra* note 36 and accompanying text. This inconsistency element is apparently determined by simply comparing the open treatment of the single transaction with that actually accorded it, tax-wise, under the barred treatment, and without reference to positions that may have been actively advocated by a particular party. *See, e.g.*, United States v. Bowcut, 287 F.2d 654 (9th Cir. 1961); United States v. Herring, 240 F.2d 225 (4th Cir. 1957). This is more in accordance with what has been suggested to be the better view in statutory mitigation, that the inconsistent position element of most of the circumstances of adjustment should only require passive inconsistency. *See* I.R.C. § 1311(b)(1); M. SALTZMAN, *supra* note 7, ¶ 5.07[2][a] at 5-40 to 5-44. Finally, there may be some question, at least insofar as the Service is concerned, whether inconsistent treatment really is a necessary element for the application of equitable recoupment. *See* Ltr. 8210004, April 28, 1980, C.C.H. Letter Rulings Rep't No. 263, March 17, 1982 (Part II) (". . . it has never been thought that equitable recoupment applies only in situations in which the opposing party has taken inconsistent positions.").

Private letter rulings issued by the Service may not be used or cited as precedent. I.R.C. § 6110(j)(3); Treas. Reg. § 301.6110-7(b) (T.D. 7524; 12-15-77). The Supreme Court has utilized them, however, as evidence of the administrative position of the Service. Rowan Cos., Inc. v. United States, 452 U.S. 247, 261 n.17 (1981). *See* Kovey & Winslow, *Supreme Court's citation of letter rulings: What does it mean to practitioners?* 55 J. TAX'N 166 (No. 3, Sept. 1981). The lower courts volved, as in *Stone*, there must also exist an identity of interest between them. But, having summarized the substantive elements from these cases, the question remains whether anything of that doctrine survives after *McEachern* and *Electric Storage Battery*.

SURVIVAL OF EQUITABLE RECOUPMENT AFTER *MCEACHERN* AND *ELECTRIC STORAGE BATTERY*

As we have seen, although the first two cases in the Supreme Court permitted equitable recoupment, the last two did not. In view of this and the seemingly absolute statutory prohibitions of the Code which were applied in *McEachern*, the question is whether the doctrine survives at all and, if so, whether its scope allows it some real, practical significance today. Short of simply regarding *McEachern* as an aberration, any satisfactory affirmative answers to these questions—and, perhaps, the very existence of the doctrine itself as a doctrine—requires first that *McEachern* and *Electric Storage Battery* be reconciled in their refusal to permit equitable recoupment.

Although the Supreme Court has not specifically reconciled the two cases, it seems possible from hindsight to view *McEachern* as doing more than merely applying the statutory prohibition against utilizing the barred deficiency for one year to wipe out the open overpayments for other years. Thus, the greater barred deficiency for 1928 resulted from the death of the decedent, thereby accelerating the reporting of the remaining gain from the installment sale in the year of death. On the other hand, the lesser open overpayments for 1929, 1930 and 1931 were caused by the administrator's erroneous continuation of reporting on the installment method. Although the overall transaction—the sale and use of the installment method—might be broadly viewed as a single, nonetheless the death of the decedent can reasonably be treated as a separate event, even though it triggered the acceleration. So also can the administrator's continuing to report on the installment method for each of the post-death years be reasonably construed as events distinct from the decedent's death. Accordingly, *McEachern* and *Electric Storage Battery* are at least potentially reconcilable on the basis that the failure of the same or single transaction element in each resulted in the inapplicability of equitable recoupment. The effect or end result of this manner of analyzing the two cases is to give paramountcy to the doctrine of equitable recoupment over the statutory prohibition in those situations where all its elements have been satisfied.

Given this potential reconciliation, the question remains whether this is reasonable in view of these plainly-worded contrary statutory prohibitions in the Code, apparently absolutely applied by the Court in *McEachern*, and

have likewise made use of them. *See, e.g.*, Regan v. Ross, 691 F.2d 81, 87 (2d Cir. 1982); Fanning v. United States, 52 A.F.T.R.2d (P-H) 83-5481, 5482 n.1 (E.D. Wash. 1983); Niles v. United States, 48 A.F.T.R.2d (P-H) 81-6068, 6072 n.2 (N.D. Cal. 1981). The Service itself apparently permits its personnel to utilize private letter rulings as a guide with other materials in formulating a district office position on issues. *See* 56 J. TAX'N 248 (No. 4, April 1982). *See also* Holden & Novey, *Legitimate Uses of Letter Rulings Issued to Other Taxpayers—A Reply to Gerald Portney*, 37 TAX LAWYER 337, 346-47 (No. 2, Winter 1984). Accordingly, private letter rulings are being used in this article to indicate not only the administrative practice of the Service but also as some evidence of its current position concerning specific issues.

which *Electric Storage Battery* itself acknowledged as ". . . seem[ing] to direct a result opposite to that asked by . . . [the taxpayer]."[81] In other words, does the doctrine of equitable recoupment survive *McEachern* and remain viable today?[82]

Because *Electric Storage Battery* was the last substantive statement of the Supreme Court on the doctrine we are left to seek the answer in the decisions of the lower courts. Their answer has been, with some trepidation,[83] that the doctrine does survive,[84] although they have given it the "limited scope" enunciated in *Electric Storage Battery* by generally construing its various prerequisites very narrowly,[85] particularly the single transaction element.[86]

There are a number of different reasons for this conclusion. First, the manner in which the Court decided *Electric Storage Battery* was significant. Its by-passing of an apparently pertinent statutory prohibition with only a cursory mention and, instead, making its determination on the basis of the failure of the single transaction element of equitable recoupment seemed to

81. *See supra* note 69 and accompanying text.

82. *See* Note, *Estoppel and Recoupment in Federal Taxation after the Revenue Act of 1938: The Effect of Section 609 of the Revenue Act of 1928, supra* note 44, at 500-02 (1939). For the relationship of equitable recoupment to the mitigation provisions of the Code and the fact that the doctrine has also survived their enactment, *see infra* notes 139-174 and accompanying text.

83. *E.g.*, Wood v. United States, 213 F.2d 660, 661 (2d Cir. 1954) ("Frankly, we do not know just how much of that doctrine still lives."). *See* Kojes v. United States, 241 F. Supp. 762, 764-65 (E.D.N.Y. 1965).

84. *E.g.*, Boyle v. United States, 355 F.2d 233 (3d Cir. 1965), *reh'g denied per curiam*, 355 F.2d 237 (3d Cir. 1966); United States v. Herring, 240 F.2d 225 (4th Cir. 1957). *See* Rev. Rul. 71-56, 1971-1 C.B. 404.

85. Where different taxpayers are involved in an equitable recoupment claim by the government, the courts have generally insisted on an absolute identity of interest between those taxpayers before allowing such a claim. This is in keeping with the equitable nature of the doctrine because it would clearly be unfair to allow the government to recoup a barred deficiency of one taxpayer against an open refund of another where all or even only a part of such refund would or could possibly inure to the benefit of innocent third parties. *E.g.*, Kramer v. United States, 406 F.2d 1363, 1371 (Ct. Cl. 1969); Smith v. United States, 373 F.2d 419, 422-24 (4th Cir. 1966); Schlemmer v. United States, 94 F.2d 77, 78 (2d Cir. 1938) (L. Hand, Circuit Judge); Sewell v. United States, 19 F. Supp. 657, 663 (Ct. Cl. 1937). *See* Estate of Vitt v. United States, 706 F.2d 871, 875 n.3 (8th Cir. 1983). *But see* O'Brien v. United States, 766 F.2d 1041, 1050 (7th Cir. 1985). In addition, where no inconsistency exists between the open and barred treatments of the single transaction, courts have denied equitable recoupment. *E.g.*, Minskoff v. United States, 490 F.2d 1283 (2d Cir. 1974)(predeath income properly subjected to both income tax and estate tax). *See* Gindes v. United States, 661 F.2d 194, 201-02 (Ct. Cl. 1981) (held, no inconsistency since otherwise barred alleged "overpayment" of income tax due to failure of partnerships to elect under § 754 to adjust bases in assets upward per § 743(b) to reflect inclusion of partnership interests in decedent's gross estate).

86. *E.g.*, Gindes v. United States, 661 F.2d 194 (Ct. Cl. 1981) (inclusion of partnership interests in gross estate on death of decedent not the same transaction as failure of partnerships to elect under § 754 to adjust bases of assets upward per § 743(b) in order to obtain greater depreciation deductions for pass-through purposes); Ellard v. United States, 228 Ct. Cl. 815 (1981) (sale by sole proprietor of diesel and motor fuels to partnership in which he was a 50 percent partner not same transaction as sales of fuel by partnership to third parties); Ford v. United States, 276 F.2d 17 (Ct. Cl. 1960) (barred estate tax deficiency due to undervaluation of shares in gross estate and open income tax overpayment on later sale due to correct, higher valuation for basis purposes; although fair market value date of death crucial for both taxes, implicit holding that not same transaction); Wood v. United States, 213 F.2d 660 (2d Cir. 1954); Twitchco, Inc. v. United States, 348 F. Supp. 330 (N.D. Ala. 1972) (a purchase of item in one year is not same transaction as the sale of such item in later year despite the fact that early erroneous deduction later included in basis with consequent double tax benefit); Missouri Public Service Co. v. United States, 245 F. Supp. 954 (W.D. Mo. 1965) (purchase of identifiable groups of assets in each of four successive years were separate transactions).

argue that the statutory provision was not necessarily controlling. This was further strengthened by the fact that the court had cited to *Bull* and *Stone* without adverse criticism. Moreover, it should not be forgotten that *McEachern* was decided only some five months after *Stone*, and it would be doubtful that, after just breathing additional meaning into recoupment, the Court would so soon relegate it to near extinction. Finally, the *Stone* opinion itself seemed to foresee this issue by acknowledging the paramountcy of another equitable doctrine over the parallel provisions of the 1928 act—sections 607 and 609(a)—where it stated that those provisions do ". . . not override a defense based on . . . estoppel . . ."[87]

Therefore, the lower courts generally have concluded that, where different years are involved, the taxpayer and the government alike could equitably recoup a barred overpayment or deficiency against an open deficiency or overpayment, respectively, at least where the narrowly construed same or single transaction, item or taxable event was present, despite *McEachern* and the existence of those seemingly absolute statutory prohibitions.[88] If equitable recoupment "died" after *McEachern*, *Electric Storage Battery* created a remarkable "Lazarus effect."[89]

With that background concerning the substantive side of equitable recoupment in the Supreme Court, it is now time to complete the story by dealing with the one case in that Court concerning the proper choice of forum for the invocation of that doctrine.

THE UNITED STATES TAX COURT AS THE SOLE PREPAYMENT FORUM AND EQUITABLE RECOUPMENT: *GOOCH MILLING & ELEVATOR CO.*

We have seen that the United States Tax Court is the sole prepayment forum available for litigating the merits of federal income, gift, estate and certain excise tax controversies. Its original precedessor was created as the Board of Tax Appeals in 1924[90] and was designated as an "independent agency in the Executive Branch of the Government."[91] Not until 1943 did the Supreme Court have the occasion to pass upon the question whether the Board possessed the power to grant equitable recoupment. In *Commissioner v. Gooch Milling & Elevator Company*,[92] the Service had asserted a deficiency against the taxpayer for its taxable fiscal year ending June 30, 1936. The Supreme Court held that the Board did not have jurisdiction to apply the doctrine of equitable recoupment so as to allow the use of a now-barred overpayment for the prior fiscal year (not before the Board) to eliminate the deficiency for the still-open fiscal year 1936 which was being litigated by the taxpayer before that tribunal. This result was mandated by that Code sec-

87. Stone v. White, 301 U.S. 532, 538 (1937).
88. See Estate of Mann v. United States, 552 F. Supp. 1132, 1142 (N.D. Tex. 1982), *aff'd*, 731 F.2d 267 (5th Cir. 1984); Note, *Equitable Recoupment in Tax Law*, 42 N.Y.U. L. Rev. 537, 544-49 (1967).
89. *See* Twitchco, Inc. v. United States, 348 F. Supp. 330, 336 (N.D. Ala. 1972).
90. Revenue Act of 1924, Pub. L. No. 176, ch. 234, § 900, 43 Stat. (part 1) 336.
91. *Id.*, § 900(k), 43 Stat. (part I) 338.
92. 320 U.S. 418 (1943).

tion which provided that the "Board in redetermining a deficiency in respect of any taxable year . . . shall have no jurisdiction to determine whether or not the tax for any other year has been overpaid or underpaid."[93] Emphasizing that it was not faced with the issue of determining the scope of equitable recoupment when it is raised ". . . in [refund suit] . . . tribunals possessing general equitable jurisdiction," the Court indicated that the Code, and not general equitable principles, provided the foundation of the jurisdiction of the Board.[94] Since that decision the Tax Court has been regarded as neither having jurisdiction to consider equitable recoupment[95] nor possessing general equity jurisdiction.[96]

The designation of that tribunal as an "independent agency in the Executive Branch" was continued by the Revenue Act of 1942[97] (and into the 1954 Code),[98] although the 1942 Act did change the name of that body to the "Tax Court of the United States,"[99] perhaps in somewhat tardy nominal recognition that it was actually a court with purely judicial functions.[100] It was not until the Tax Reform Act of 1969 (T.R.A. 1969),[101] however, that it lost its "independent agency" designation, becoming an Article I legislative court under the name of the "United States Tax Court."[102] Although T.R.A. 1969 did grant the Tax Court some incidental powers which it had not previously possessed, including the power of contempt,[103] it has been held that this change of status did not confer equitable jurisdiction.[104] It seems clear, therefore, that the Tax Court does not currently have the power to consider a claim of equitable recoupment.[105]

The bottom line is that it is not possible to litigate the claim for equitable recoupment prior to payment. Instead, that doctrine is available only in

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93. Internal Revenue Code of 1939, § 272(g), Pub. L. No. 1, 53 Stat. 83-84. *See* 320 U.S. 418, 420-21 (1943). For the current statutory provision, *see* I.R.C. § 6214(b).

94. 320 U.S. 418, 421-22 (1943).

95. Continental Equities, Inc. v. Commissioner, 551 F.2d 74 (5th Cir. 1977); Rev. Rul. 71-56, 1971-1 C.B. 404. *See, e.g.*, Purdy v. Commissioner, 45 T.C.M. 74, 77 (1982).

96. *See* First Security Bank of Idaho v. Commissioner, 592 F.2d 1046, 1048 (9th Cir. 1979); Continental Equities, Inc. v. Commissioner, 551 F.2d 74, 82, 84 (5th Cir. 1977); Morse v. United States, 494 F.2d 876, 879 (9th Cir. 1974); Andrews, *The Use of the Injunction as a Remedy for an Invalid Federal Tax Assessment*, 40 TAX. L. REV. 653, 710 & n.351 (1985). There is, however, some implication in Tax Court opinions that it has jurisdiction to apply the doctrine of equitable estoppel. *See* Doner v. Commissioner, 48 T.C.M. 1276, 1277 (1984). *See generally* H. DUBROFF, THE UNITED STATES TAX COURT—AN HISTORICAL ANALYSIS 488-93 (1979).

97. Revenue Act of 1942, § 504(b), Pub. L. No. 753, ch. 619, 56 Stat. 957.

98. *See* Ferguson, *Jurisdictional Problems in Federal Tax Controversies*, 48 IOWA L. REV. 312, 352 (1963).

99. *Id.* at 352 n.205.

100. *Id.* at 355.

101. Pub. L. No. 91-172, 83 Stat. 487 (1969).

102. I.R.C. § 7441.

103. Pub. L. No. 91-172, § 956, 83 Stat. 732 (1969). *See* I.R.C. § 7456(e); S. REP. No. 552, 91st Cong., 1st Sess. 302, 304 (1969).

104. Continental Equities, Inc. v. Commissioner, 551 F.2d 74, 84 (5th Cir. 1977). *See* Ternovsky v. Commissioner, 66 T.C. 695, 698 (1976); Burns, Stix Friedman & Co. v. Commissioner, 57 T.C. 392, 396 (1971); Purdy v. Commissioner, 45 T.C.M. 74, 76-77 (1982); Rothbart v. Commissioner, 42 T.C.M. 1128, 1130 (1981); Evans v. Commissioner, 42 T.C.M. 602, 604 (1981); Rev. Rul. 71-56, 1971-1 C.B. 404.

105. Moreover, it appears that a circuit court, on an appeal from the United States Tax Court, would be similarly circumscribed. *See* H. DUBBOFF, *supra* note 96, at 487.

a refund suit forum, either the United States Claims Court[106] or a United States District Court.[107] Because of this fact and the exclusivity of Tax Court jurisdiction once properly invoked,[108] it is advisable to determine in advance of commencing action in that court whether equitable recoupment is an important issue in the controversy because the mere timely filing of a petition for redetermination in the Tax Court generally will operate to bar a suit for refund.[109]

It is now appropriate to place equitable recoupment in its overall context, to obtain an overview of the position it occupies generally with respect to the tax statutes of limitation.

THE RELATIONSHIP OF EQUITABLE RECOUPMENT TO THE DOCTRINE OF SET OFF AND TO THE STATUTORY MITIGATION PROVISIONS

Equitable recoupment is intimately related to certain other tax principles having their source in case law and statute which likewise serve the function of negating the limitations bar in specific circumstances. These are the judicially created doctrine of set off and the statutory provisions of the Code which mitigate the effect of the tax statutes of limitation.[110] It becomes crucial to distinguish these latter from the former in order to be able to understand fully the applicability of equitable recoupment and when it may properly be invoked.

Equitable Recoupment versus Set Off: Lewis v. Reynolds

Although often mistakenly confused with,[111] or regarded as interchangeable with,[112] equitable recoupment, set off is correctly treated as a separate and distinct doctrine.[113] The principal case is *Lewis v. Reynolds*.[114] There, the estate filed its final income tax return for the period January 1 to December 12, 1920 on February 18, 1921 and paid the tax shown to be due.

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106. *See* Bull v. United States, 295 U.S. 247 (1935) (case originated in the Court of Claims); note 3, *supra*; S. REP. No. 275, 97th Cong., 1st Sess. 13, 22 (1981) *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS (vol. 2) at 23, 32; H. DUBROFF, *supra* note 96 at 487 n.903 (1979).

107. *See* Stone v. White, 301 U.S. 532 (1937) (case originated in the federal district court).

108. I.R.C. § 6512(a).

109. *Id. E.g.*, United States v. Wolf, 238 F.2d 447, 449 (9th Cir. 1956); Dorl v. Commissioner, 57 T.C. 720 (1972), *aff'd per curiam*, 507 F.2d 406 (2d Cir. 1974); Fiorito v. Commissioner, 42 T.C.M. 1328 (1981). Likewise, such a timely filed petition may not be withdrawn without prejudice. *See* Johnson v. Commissioner, 37 T.C.M. 189 (1978). The Tax Reform Act of 1986 [hereinafter T.R.A. 1986], however, now permits a statutory notice of deficiency that has been mailed to the taxpayer to be rescinded by *mutual agreement* of the Secretary and the taxpayer, for purposes of, *inter alia*, § 6512(a). T.R.A. 1986, Pub. L. No. 99-514, § 1562, — Stat. — adding new I.R.C. § 6212(d).

110. For a discussion of other doctrines, including that of equitable estoppel, sometimes utilized to avoid the statute of limitations, *see* Maguire (part 1), *supra* note 16, at 511-15; note 14, *supra*.

111. *See, e.g.*, Estate of Bender v. Commissioner, 86 T.C. 770 at 778 (1986).

112. *See, e.g.*, Ltr. 8215011, Dec. 29, 1981, C.C.H. Letter Rulings Rep't No. 268, Apr. 21, 1982 (Part II).

113. *See* M. SALTZMAN, *supra* note 7, 1986 Cum. Supp. No. 1, at S5-13; Willis, *Some Limits of Equitable Recoupment, Tax Mitigation and Res Judicata: Reflections Prompted by* Chertkof v. United States, 38 TAX LAWYER 625, 633 & n.63 (1985); Note, *Equitable Recoupment in Tax Law*, 42 N.Y.U. L. REV. 537, 541-42 (1967).

114. 284 U.S. 281 (1932). For some fairly recent applications of *Lewis v. Reynolds* by the Service, *see* Rev. Rul. 81-87, 1981-1 C.B. 580; Rev. Rul. 81-88, 1981-1 C.B. 585.

On that return the estate claimed an attorney fee deduction of $20,750 and a state inheritance tax deduction of $16,870. After audit, the Service erroneously allowed the greater deduction, erroneously disallowed the lesser, and timely assessed a deficiency of about $7,300 on November 24, 1925. The estate paid this deficiency in March 1926, and in late July 1926 filed a timely claim for refund. It was not until mid-May 1929 that the Service responded to this refund claim, by which time the then-applicable five year statute of limitation on assessment had expired.[115] Acknowledging the erroneous nature of both the prior allowance and disallowance of, respectively, the greater and lesser deductions, the Service denied the claim on the basis that the correct computation showed a further net deficiency despite the fact that the statute of limitation barred assessment.[116]

The district court and the court of appeals agreed with the Service. Emphasizing that a taxpayer is not entitled to a refund unless an overpayment of tax was in fact made, the Supreme Court affirmed.[117] The Court stated:

> An overpayment must appear before a refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments received when they do not exceed the amount which might have been properly assessed and demanded.[118]

In sum, the Court, in *Lewis v. Reynolds*, permitted the government to set off a greater barred deficiency item (the improperly allowed $20,750 attorney fee deduction) against a lesser open refund item (the improperly disallowed $16,870 state inheritance tax deduction) in order to wipe out the refund otherwise due the taxpayer, but no more than that. Consequently, the statute of limitations on assessment was avoided to that extent, and the justification for it was a fundamental lack of actual overpayment.[119]

115. Lewis v. Reynolds, 284 U.S. 281, 282 & n.1 (1932).

116. *Id.* at 282.

117. *Id.* at 282-83.

118. *Id.* at 283.

119. That *Lewis v. Reynolds* resulted in a victory for the government can obscure the fact that its principle may also protect the taxpayer. For example, assume that, after audit, the Service proposes to disallow a $10,000 business entertainment deduction claimed by a cash basis taxpayer (*T*). *T* is fairly certain that he can win on this issue if he litigates it, but he is worried about a potential $20,000 of additional gross income due to a constructive receipt issue concerning a fee, such issue not yet raised by the Service. If *T* were to litigate in the Tax Court, he would face the danger of an increased deficiency being asserted by the Service in its answer based upon the new constructive receipt issue. The burden of proof as to the new issue raised for the first time in the Service's answer would be on the government. Tax Court Rule 142(a). There are sad cases, however, where the Service has been able to prove greatly increased deficiencies. *E.g.*, Ferguson v. Commissioner, 47 T.C. 11 (1966); Raskob v. Commissioner, 37 B.T.A. 1283 (1938), *aff'd sub nom.*, DuPont v. Commissioner, 118 F.2d 544 (3d Cir. 1941), *cert. denied*, 314 U.S. 623 (1941). A similar situation can arise in a refund suit forum on a government counterclaim for additional tax. *See, e.g.*, Bush v. United States, 109 F. Supp. 254 (Ct. Cl. 1953). Assuming that no extended statute of limitation on assessment is implicated, however, *T* generally can protect himself from this danger of an increased deficiency in the Tax Court or of a counterclaim for additional tax in the district court or Claims Court. This arises due to the essentially co-terminus nature of the two applicable statutes of limitation. The government generally has three years from the time the return was filed to assert a deficiency. I.R.C. § 6501(a). The *T* must generally file a claim for refund within the later of three years from the time the return was filed or two years from the time the tax was paid. *Id.* § 6511(a). By first paying the deficiency based upon the disallowed $10,000 business entertainment deduction and

Set Off Also Available to the Taxpayer

Although *Lewis v. Reynolds* illustrates the traditional and probably more common use of set off by the government, that doctrine, similarly to equitable recoupment, is also available to the taxpayer.[120] Thus, it apparently may be asserted by the taxpayer as a defense to the government's suit to recover an erroneous refund under Code section 7405.[121] In a taxpayer's refund suit, the taxpayer may also utilize set off for the limited purpose of defending against the government's raising of that defense. In other words, the taxpayer may set off barred refund items against the government's set off of barred deficiency items against the taxpayer's open refund items, all involving the same tax and taxable period, if applicable.[122]

Distinctions Relating to Taxpayer, Tax, Taxable Period, if Applicable, and Single versus Separate Transactions

From *Lewis v. Reynolds* itself it is clear that set off traditionally involves the same tax, taxpayer and taxable year or other period, if applicable. Within that limited context, clearly separate items or transactions may be utilized in the offset. Thus, the $20,750 attorney fee deduction was obviously separate and distinct from the $16,870 state inheritance tax deduction. In contrast, equitable recoupment most commonly involves two different taxes, the same taxpayer and includes a single item or transaction.[123] The classic case, as we have seen, is *Bull v. United States* where the receipt by the

proceeding on the refund suit route rather than litigating in the Tax Court, and by filing the claim for refund in timely fashion, just before (or after, but still timely) the statute of limitation on assessment expires, the Service will not have sufficient time to assert any further deficiency attributable to the constructive receipt issue. Consequently, the best that the government will be able to do in the refund suit litigation is to claim a set off of the barred $20,000 additional gross income constructive receipt deficiency item against the open $10,000 business entertainment expense refund item in order to wipe out *T*'s refund right, but not to obtain any additional tax. Accordingly, *T* has utilized *Lewis v. Reynolds* to protect himself from the danger of having to pay additional tax arising from an as-yet undiscovered issue concerning constructive receipt while preserving his right to litigate the merits of his business entertainment deduction. *See* M. GARBIS & S. STRUNTZ, TAX PROCEDURE AND TAX FRAUD: CASES AND MATERIALS 236-37 (1982).

120. *See* Dysart v. United States, 340 F.2d 624, 627-28 (Ct. Cl. 1965).

121. *See* Union Pac. R.R. v. United States, 389 F.2d 437, 446-47 (Ct. Cl. 1968); United States v. Pusey, 47 F.2d 22 (9th Cir. 1931). On the other hand, equitable recoupment apparently may not be utilized by the taxpayer to retain a refund made erroneously (because made after the expiration of the statute of limitation). United States v. Tomar Hills, Inc., 783 F.2d 753 (8th Cir. 1986). *See* I.R.C. § 7405(a).

122. Union Pac. R.R. v. United States, 389 F.2d 437, 447 (Ct. Cl. 1968).

123. Less common situations where equitable recoupment could apply include the same type of tax (non-income tax) and different taxpayers with a sufficient identity of interest between them, coupled with a single item inconsistently treated. *E.g.*, Estate of Vitt v. United States, 706 F.2d 871 (8th Cir. 1983) (Real estate held by husband (*H*) and wife (*W*) as tenants by the entirety conveyed to children and grandchildren with reserved life estate for *H* and *W* and the survivor. On *H*'s death the Service erroneously included more than one-half of the entire value of the real estate—about 76%—in his gross estate. On later death of *W*, Service changed position and properly included 50%—instead of only remaining 24%—in *W*'s gross estate. Held, *W*'s estate could equitably recoup the barred estate tax overpayment of *H*'s estate against its own open estate tax deficiency). *See* Stone v. White, 301 U.S. 532 (1937) (income tax, now pre-empted by Code section 1312(5), a statutory mitigation provision). A rarer application involves the same type of tax, taxpayer and different years where the situation does not fit within any described circumstance of adjustment in the statutory mitigation provisions. *See* I.R.C. § 1312; Kolom v. United States, 791 F.2d 762 (9th Cir. 1986) (held, minimum tax on preference income paid by taxpayer with respect to the same bargain element of certain stock options in each of two years not within meaning of the double inclusion in *gross*

estate of post-death partnership profits was inconsistently subjected to both estate and income taxation.

The Equities

Because the justification underpinning the doctrine of set off in the tax refund suit context is the fundamental necessity of establishing an actual overpayment, it has been said that set off is to be applied unconditionally and is not subject to equitable considerations.[124] Consequently, the right to claim set off is not prevented, for example, by the government's delay, inaction or negligence in failing to assert a tax deficiency in timely fashion, or the burden or hardship imposed on the other party.[125]

The doctrine of recoupment, on the other hand, is rooted in equity.[126] It is, therefore, not surprising that its elements promote equitable notions. Illustratively, the component of inconsistent treatment reflects the view that the party against whom recoupment is sought should not be permitted, morally and in good conscience, to obtain a benefit from its own inconsistency.[127] Likewise, where two different taxpayers are involved, the requisite of a sufficient identity of interest between them, in a claim for equitable recoupment by the government, is simply a recognition of the need to protect the interests of innocent third parties.[128]

Some limits exist, however, to the "equitableness" of equitable recoupment. For example, in *Bull v. United States,* the executor had up to one month to file a timely claim for refund of the estate tax overpayment after being notified of the income tax deficiency assertion by the Service. The executor's failure to so file, however, did not prevent his later successful claim of recoupment of the subsequently barred estate tax overpayment.[129] Therefore, some lack of diligence on the part of either the taxpayer[130] or the government[131] in the timely pursuit of its claim does not foreclose the application of equitable recoupment.[132]

In the same vein, it has been said that the doctrine ". . . cannot be invoked by a party who lacks 'clean hands.' "[133] Thus, in situations where there is fraud by the taxpayer, one might suppose that party could not raise equitable recoupment. But in such case one must be careful to identify the

income circumstance of adjustment in section 1312(1) due to the exclusionary provision of section 421(a)(1); consequently, equitable recoupment allowed).

124. Dysart v. United States, 340 F.2d 624, 627-28 (Ct. Cl. 1965).

125. *Id.* at 628-30.

126. *See* Stone v. White, 301 U.S. 532, 535-39 (1937); Bull v. United States, 295 U.S. 247, 260-61 (1935).

127. *See* Bull v. United States, 295 U.S. 247 (1935); note 80, *supra.*

128. *See supra* note 85.

129. *See supra* note 27.

130. *Id. See* Ltr. 8333007, May 16, 1983, CCH Letter Rulings Rep't No. 338, Aug. 24, 1983 (Part II).

131. *See* Ltr. 8210004, Apr. 28, 1980, CCH Letter Rulings Rep't No. 263, March 17, 1982 (Part II).

132. *See* Holzer v. United States, 250 F. Supp. 875, 878 (E.D. Wis.), *aff'd per curiam,* 367 F.2d 882 (7th Cir. 1966) (". . . laches is not a defense to a claim for equitable recoupment. . . ."). *But see* Wilmington Trust Co. v. United States, 610 F.2d 703, 714-15 (Ct. Cl. 1979).

133. Minskoff v. United States, 349 F. Supp. 1146, 1150 (S.D.N.Y. 1972), *aff'd,* 490 F.2d 1283 (2d Cir. 1974).

precise thing to which the fraud was directed. Assume, for example, that there is an open pre-death income tax deficiency of the decedent due to fraud. Such a liability constitutes a deductible claim against the estate for federal estate tax purposes.[134] If the federal estate tax return has already been filed and tax paid without taking into account such a deduction, it automatically results in a federal estate tax overpayment which may be barred. If that is the case, does the fraud prevent the application of the doctrine?

The answer of the few courts considering this issue has been that the estate may still equitably recoup the barred estate tax overpayment against the open income tax deficiency.[135] The reason is that, if the estate had been able to file the estate tax refund claim in timely fashion, the existence of fraud with respect to the decedent's income taxes would not have precluded the estate tax recovery.[136] In other words, the fraud is not directly related to the estate tax equitable recoupment claim. The fraud occurred as to the pre-death income tax liability, not the estate tax. As to the latter, only an erroneous overreporting of estate tax liability occurred.[137] But if the fraud were directed at the estate tax, a different result might well be produced. For example, if the estate had attempted to conceal the pre-death income tax liability by misrepresenting (overreporting) the size of the taxable estate, that would directly relate the fraud to the basis of the recoupment claim and could justify its denial.[138]

Given the exception for some lack of diligence and the qualification concerning fraud and the "clean hands" doctrine, the general equitable nature of recoupment nonetheless seemed well-established. With that background it is now time to turn to the relationship of equitable recoupment to the statutory mitigation provisions. In order for this to be comprehensible, it must be prefaced with a very brief and simplified description of statutory mitigation.

Equitable Recoupment and Statutory Mitigation

Sometimes unflatteringly described as being "among the most arcane and technical"[139] as well as "convoluted"[140] provisions in the Internal Revenue Code, the mitigation sections[141] were originally enacted in 1938.[142] They can be viewed as serving a necessary remedial function with respect to our annual accounting concept in federal taxation. This is so because that accounting principle is obviously directed to taxable years rather than trans-

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134. I.R.C. § 2053(a)(3); Treas. Reg. §§ 20.2053-1(a)(1)(iii) (1958); 20.2053-6(a), (f) (first sentence) (1958).

135. United States v. Bowcut, 287 F.2d 654, 656 (9th Cir. 1961). *See* United States v. Herring, 240 F.2d 225 (4th Cir. 1957) (recoupment allowed, but without discussion of the fraud aspect).

136. United States v. Bowcut, 287 F.2d 654, 656 (9th Cir. 1961).

137. *Id.*

138. *Id.*

139. Gindes v. United States, 661 F.2d 194, 200 n.18 (Ct. Cl. 1981).

140. O'Brien v. United States, 766 F.2d 1038, 1041 (7th Cir. 1985).

141. I.R.C. §§ 1311-14. For the statutory mitigation provision dealing with the interaction of the Chapter 2 tax on self-employment income and the F.I.C.A. tax imposed by § 3101, *see* I.R.C. § 6521. For purposes of this article, any reference to "statutory mitigation" or to "the statutory mitigation provisions" and the like refer to I.R.C. §§ 1311-14.

142. Revenue Act of 1938, ch. 289, § 820, 52 Stat. 581.

actions or events, and the latter may overlap into or affect more than one taxable year.[143] Because of this remedial purpose, the consequence of their application is to re-open an otherwise barred year to correct the error in question. Courts have differed, however, as to whether these statutory provisions should be narrowly or strictly construed[144] in order to promote the goals of statutes of limitation generally or liberally interpreted because of their remedial nature.[145]

In any event, the mitigation provisions constituted an attempt by Congress to provide a statutory solution to some of the same problems to which case law doctrines, including recoupment, had been directed.[146] Therefore, it is not surprising that these sections include attributes or elements of equitable recoupment,[147] although they admittedly go much further than the doctrine within their sphere.[148] As they were intended only as a partial solution, however, and not to solve all inequities occasioned by the limitation

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143. Willis, *supra* note 113, at 626 & n.13. *See* O'Brien v. United States, 766 F.2d 1038, 1041 (7th Cir. 1985).

144. *E.g.*, Central Hanover Bank & Trust Co. v. United States, 163 F.2d 60, 63-64 (2d Cir. 1947); American Foundation Co. v. Commissioner, 2 T.C. 502 (1943).

145. *E.g.*, First Nat'l Bank of Omaha v. United States, 565 F.2d 507, 514-16 (8th Cir. 1977); Gooding v. United States, 326 F.2d 988, 992, 993 n.9 (Ct. Cl.), *cert. denied*, 379 U.S. 937 (1964). *See* Note, *Equitable Recoupment in Tax Law*, 42 N.Y.U. L. REV. 537, 543 n.39 (1967); Note, *Sections 1311-15 of the Internal Revenue Code: Some Problems in Administration*, 72 HARV. L. REV. 1536, 1543-46 (1959).

146. *See generally* Maguire, pt. 1, *supra* note 16, at 511 *et seq.*

147. *See, e.g.*, Kolom v. United States, 791 F.2d 762, 766 n.10 (9th Cir. 1986); First Nat'l Bank of Omaha v. United States, 565 F.2d 507, 512, 514, 518 (8th Cir. 1977); Dysart v. United States, 340 F.2d 624, 628 (Ct. Cl. 1965); Maguire, pt. 1, *supra* note 16, at 528-31; Note, *Equitable Recoupment in Tax Law*, *supra* note 145, at 543; Note, *Sections 1311-15 of the Internal Revenue Code: Some Problems in Administration*, *supra* note 145, at 1537-38; Note, *Estoppel and Recoupment in Federal Taxation after the Revenue Act of 1938*, 52 HARV. L. REV. 300 (1938). For example, equitable recoupment allows the barred year's deficiency or overpayment to be used to reduce or eliminate the open year's overpayment or deficiency, respectively, despite the statutes of limitation. *Compare* Stone v. White, 301 U.S. 532 (1937) (barred federal income tax deficiency of sole trust income beneficiary used by the government against the trust's open federal income tax overpayment) *with* Bull v. United States, 295 U.S. 247 (1935) (barred federal estate tax overpayment of approximately $42,000 used by the estate against the estate's open federal income tax liability of about $63,000). The mitigation provisions have expanded on equitable recoupment's use of the barred year's error in this limited sense to actually reopen the barred year to correct the item involved. *See* I.R.C. §§ 1311(a), 1314. Likewise, the inconsistent treatment aspect of equitable recoupment has been made applicable to the majority of the circumstances of adjustment in statutory mitigation. *Cf.* Bull v. United States, *supra* (government first erroneously included an item in the gross estate for federal estate tax purposes and then correctly included the same item in the estate's gross income for federal income tax purposes. The Court noted that profits earned subsequent to the decedent's death could not be both corpus and income of the estate for purposes of both taxes.) *with* I.R.C. § 1311(b)(1). *See* Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 299-300 (1946).

148. The effect of the mitigation sections is to reopen the barred year to correct the error as to the item in question. Correction of such error will produce either a deficiency or an overpayment which can be collected or recovered, as the case may be, for that reopened year. *See* I.R.C. §§ 1314(a), (b). Equitable recoupment will only permit the *barred* year's error to reduce or eliminate the *open* year's deficiency or over-payment, but does not go further and thereby create an overpayment where a deficiency had existed or create a deficiency where an overpayment had existed, as to such open year, on behalf of either the taxpayer or the government, respectively, as the case may be. In sum, equitable recoupment does not actually reopen the barred year and can never independently produce either a deficiency or an overpayment. *See* Stone v. White, 301 U.S. 532, 539 (1937) (equitable recoupment diminishes right to recover); United States v. Gulf Oil Corp., 485 F.2d 331, 333 (3d Cir. 1973); Brigham v. United States, 470 F.2d 571, 577-78 (Ct. Cl. 1972); Evans Trust v. United States, 462 F.2d 521, 525-26 (Ct. Cl. 1972).

bar,[149] Congress apparently did not envision them as entirely displacing these judicial doctrines, but rather serving as a supplement to them.[150]

Specifically, the statutory mitigation provisions deal solely with income taxes.[151] Likewise, the benefit of these provisions is equally available to either the taxpayer or the government.[152] In that context, they can apply where, as between two taxable years, any of the following errors, otherwise known as "circumstances of adjustment",[153] occur: a double inclusion of an item in gross income,[154] a double allowance of a deduction or credit,[155] a double exclusion of an item of gross income,[156] and a double disallowance of a deduction or credit.[157] Other circumstances of adjustment where statutory mitigation may apply include errors concerning (1) correlative deductions and inclusions, respectively, between either a trust or estate and beneficiaries, heirs or legatees,[158] or (2) correlative deductions and credits between certain related corporations.[159] The final circumstance of adjustment con-

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149. *See* Evans Trust v. United States, 462 F.2d 521, 524 (Ct. Cl. 1972); Gooding v. United States, 326 F.2d 988, 990 (Ct. Cl. 1964), *cert. denied*, 379 U.S. 937 (1964); Olin Mathieson Chem. Corp. v. United States, 265 F.2d 293, 296 (7th Cir. 1959); Aaron G. Lowery Ins. Agency, Inc. v. United States, 51 A.F.T.R.2d (P-H) 83-1292, 1294 (E.D.N.C. 1983); Provident Nat'l Bank v. United States, 507 F. Supp. 1197, 1200 (E.D. Pa. 1981); Brennan v. Commissioner, 20 T.C. 495, 500 (1953).

150. S. REP. No. 1567, 75th Cong., 3d Sess. 49 (1938); Benenson v. United States, 385 F.2d 26, 32 n.8 (2d Cir. 1967).

151. *E.g.*, Treas. Reg. § 1.1311(a)-2(b) (T.D. 6162 republished in T.D. 6500 (1960)); Hess v. United States, 537 F.2d 457, 463 (Ct. Cl. 1976), *cert. denied*, 430 U.S. 931 (1977); Evans Trust v. United States, 462 F.2d 521, 524-25 & n.2 (Ct. Cl. 1972); Provident Nat'l Bank v. United States, 507 F. Supp. 1197, 1200-02 (E.D. Pa. 1981); Ltr. 8441003, June 6, 1984, C.C.H. Letter Rulings Rep't No. 398, Oct. 17, 1984 (Part II). *See* Georgia Ketteman Trust v. Commissioner, 86 T.C. 91, 110 (1986) (mitigation not applicable to gift taxes). To the same effect are the commentators, in reverse chronological order: Willis, *supra* note 113, at 648-54; 14 MERTENS LAW OF FEDERAL INCOME TAXATION, ch. 60, § 60.05 at 19 n.7 (1984); M. SALTZMAN, *supra* note 7, ¶ 5.07 at 5-34; M. FERGUSON, J. FREELAND & R. STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 133 (1970) (mitigation not applicable to cases involving both income and estate tax liability); Note, *Equitable Recoupment in Tax Law*, 42 N.Y.U. L. REV. 537, 543-44, 549 (1967); Maguire, pt. 2, *supra* note 16, at 773, 775 & n.199; Note, *Estoppel and Recoupment in Federal Taxation After the Revenue Act of 1938*, 52 HARV. L. REV. 300 (1938). Only the Fourth Circuit is to the contrary. Chertkof v. United States, 676 F.2d 984 (4th Cir. 1982), criticized in Willis, *supra*.

Some of the principal reasoning in support of this generally accepted conclusion that the statutory mitigation provisions of Code §§ 1311-14 apply only to income taxes is as follows. First, when originally enacted in 1938, these provisions expressly required that there be a determination "under the income tax laws." Revenue Act of 1938, ch. 289, § 820(a)(1) & (b), 52 Stat. 581 (1938). That exact language was continued in the 1939 Code when the mitigation sections were located in a general administrative provisions subtitle. Internal Revenue Code of 1939, Subtitle D, § 3801(a)(1) & (b); Willis, *supra*, at 648 & n.163. In the 1954 re-codification, Congress switched the mitigation sections from their old location in the general administrative provisions of the 1939 Code to the income tax subtitle of the new Code. Consequently, Congress deleted the words "under the income tax laws" which it now regarded as superfluous. *Id.*, and at 651-52. *See* Internal Revenue Code of 1954, §§ 1311-15. Therefore, the specific legislative deletion of the words "under the income tax laws" should not be taken as evidence of Congressional intent to expand the application of the mitigation sections. Willis, *supra* note 113, at 651-52.

152. I.R.C. § 1314(a), (b), (c). *See* I.R.C. § 1311(b)(1)(A), (B).

153. *Id.* § 1312.

154. *Id.* § 1312(1).

155. *Id.* § 1312(2).

156. *Id.* § 1312(3)(A) & (B). *Compare* Birchenough v. United States, 410 F.2d 1247 (Ct. Cl. 1969) *with* Estate of Kappel v. Commissioner, 615 F.2d 91 (3d Cir. 1980). *See* M. SALTZMAN, *supra* note 7, ¶ 5.07[4][c] at 5-53 to 55.

157. I.R.C. § 1312(4).

158. *Id.* § 1312(5).

159. *Id.* § 1312(6).

cerns the basis of property after erroneous treatment of a prior transaction.[160] It should be noted that these circumstances of adjustment can generally apply where different taxpayers are involved if they are "related taxpayers."[161] This may be a considerable statutory embellishment of the identity of interest aspect of equitable recoupment.[162]

In general, where the facts of a given case show a final determination[163] for an open year coming within one of these circumstances of adjustment, and, on the date of that determination, correction of the error referred to in the particular circumstance was barred, for example, by a statute of limitation, then the re-opening of the otherwise barred year may be permitted in order to correct the error.[164] A majority of the various circumstances of adjustment requires one additional element, however, before reopening can occur: maintenance of an inconsistent position.[165] That is, the winning position of the party (be it the taxpayer or the government) with respect to the open determination year must have been inconsistent with respect to the tax treatment accorded the matter in the otherwise barred year.[166]

Although greatly oversimplified, the foregoing description of statutory mitigation does convey the general concept and its utilization of elements of equitable recoupment, including that of inconsistency.[167] For purposes of this article, the important thing to remember is that the circumstances of adjustment in statutory mitigation deal only with income taxes.[168]

In this milieu, it has been held that, where the facts of the particular tax controversy fall within one of the described circumstances of adjustment, statutory mitigation supersedes other common law remedies including equitable recoupment.[169] Accordingly, where such is the case, but no re-opening or adjustment is made with respect to the otherwise barred year due to the failure of some other prerequisite in these provisions,[170] then equitable re-

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160. *Id.* § 1312(7).

161. *Id.* §§ 1312, 1313(c).

162. *See* Maguire, part 1, *supra* note 16, at 531-32.

163. For the definition of a "determination," see I.R.C. § 1313(a).

164. *See id.* § 1311(a). For the method of correction and the limited nature of the re-opening of the otherwise barred year, *see id.* § 1314.

165. *See id.* § 1311(b)(1). For the circumstances of adjustment not requiring inconsistency for re-opening, *see id.* § 1311(b)(2)(A) & (B).

166. *See* M. SALTZMAN, *supra* note 7, ¶ 5.07[2][a] at 5-41; Maguire, part 2, *supra* note 16, at 735.

167. For the differing views of the courts concerning whether active or passive inconsistency is required by the mitigation provisions, *see* M. SALTZMAN, *supra* note 7, ¶ 5.07[2][a][i] at 5-41 to 44. *See also* note 80, *supra*.

168. *See supra* note 151. For a general explanation of statutory mitigation, *see* M. SALTZMAN, *supra* note 7, ¶ 5.07 at 5-32 to 66.

169. *E.g.*, Gooding v. United States, 326 F.2d 988, 995-96 (Ct. Cl. 1964), *cert. denied*, 379 U.S. 937 (1964). *See* Benenson v. United States, 385 F.2d 26, 32 n.8 (2d Cir. 1967); Maguire, part 2, *supra* note 16, at 773-75.

170. For example, in a case where the § 1312(7) basis circumstance of adjustment applies, an inconsistent position must also be maintained. I.R.C. § 1311(b)(1)(A) & (B). The lack of such maintenance results in failure to satisfy a necessary precondition to the operation of this statutory remedy so that no adjustment of the tax liability for an otherwise barred year is allowed. Brigham v. United States, 470 F.2d 571 (Ct. Cl. 1972). The same would be true if a "determination" as required by the statute were not yet in existence. I.R.C. §§ 1311(a), 1313(a). *E.g.*, Parks v. United States, 37 A.F.T.R.2d (P-H) 76-1107 (E.D. Wis. 1976). *See* First Nat'l Bank of Omaha v. United States, 565 F.2d 507, 511 n.8 (8th Cir. 1977); Benenson v. United States, 385 F.2d 26, 30-31 (2d Cir. 1967). Likewise, even if all of the substantive prerequisites have been met, failure to proceed within the time

coupment is not available as an alternative because Congress intended statutory mitigation to be exclusive.[171] Likewise, as recoupment is a judicially created equitable remedy, it should not be available where statutory mitigation itself will constitute, either presently or in the future, an adequate remedy at law.[172] Finally, if all the prerequisites of statutory mitigation are satisfied, then it will operate without regard to any equities outside its precise terms that may be present in the specific case.[173] On the other hand, where the facts of the particular controversy do not come within any of the circumstances of adjustment of statutory mitigation, equitable recoupment is potentially available as a remedy.[174]

Up to now we have seen that set off applies to cases where the same tax, taxpayer and taxable period, if applicable, are involved. It is also clear that statutory mitigation deals solely with income taxes. Given these propositions, it is now possible to indicate the general categories of cases to which equitable recoupment may apply today.

General Applicability of Modern-Day Equitable Recoupment

A. Two Tax Cases

Usually, equitable recoupment is potentially available as a remedy where two different types of taxes are implicated, at least one of which is not an income tax.[175] These two tax cases may usefully be further divided into two different categories or models. The first category is where an item of receipt, expenditure or other transaction is potentially subject to one of two taxes, but not both. The classic example is *Bull v. United States* where the receipt by an estate of post-death partnership profits could not, in the circumstances of that case, be treated both as estate corpus and, therefore, subject to the estate tax while also being estate income and subject to the income

period allowed by the special limitation statute applicable to statutory mitigation—within one year measured from the date of the determination—prevents adjustment. I.R.C. § 1314(b); Treas. Reg. 1.1314(b)-1(b) (1974). *See* Parks v. United States, 37 A.F.T.R.2d (P-H) 76-1107, 1109 (E.D. Wis. 1976).

171. Brigham v. United States, 470 F.2d 571, 577 (Ct. Cl. 1972); Gooding v. United States, 326 F.2d 988, 995-96 (Ct. Cl. 1964), *cert. denied*, 379 U.S. 937 (1964). *See* Benenson v. United States, 385 F.2d 26, 32 n.8 (2d Cir. 1967); M. FERGUSON, J. FREELAND & R. STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 131 n.377 (1970); Maguire, part 2, *supra* note 16, at 733-35; Note, *Equitable Recoupment in Tax Law*, *supra* note 145, at 543-44; Note, *Sections 1311-15 of the Internal Revenue Code: Some Problems in Administration*, *supra* note 145, at 1537 & n.8. *But see* First Nat'l Bank of Omaha v. United States, 565 F.2d 507, 516 nn.16 & 17 (8th Cir. 1977).

172. Benenson v. United States, 385 F.2d 26, 31-34 (2d Cir. 1967); Wells Fargo Bank & Union Trust Co. v. United States, 245 F.2d 524, 535-36 (9th Cir. 1957). *See* Parks v. United States, 37 A.F.T.R.2d (P-H) 76-1107 (E.D. Wis. 1976). *But see* First Nat'l Bank of Omaha v. United States, 565 F.2d 507, 514-16 (8th Cir. 1977).

173. *See* Dysart v. United States, 340 F.2d 624, 628 (Ct. Cl. 1965).

174. *See* Ltr. 8441003, June 6, 1984, C.C.H. Letter Rulings Rep't No. 398, Oct. 17, 1984 (Part III); Maguire, part 2, *supra* note 16, at 773, 775 & n.199; Note, *Equitable Recoupment in Tax Law*, *supra* note 171; Note, *Estoppel and Recoupment in Federal Taxation After the Revenue Act of 1938*, *supra* note 147, at 300 & n.3.

175. *See* Note, *Estoppel and Recoupment in Federal Taxation After the Revenue Act of 1938*, *supra* note 147, at 300 (1938) (statutory mitigation not applicable "unless both taxes are income taxes."). Income taxes within the scope of statutory mitigation include those taxes imposed by subtitle A of the Code. Treas. Reg. § 1.1311(a)-2(b) (T.D. 6162, republished in T.D. 6500, 11-25-60).

tax. This class of two tax cases will be referred to from now on as the *Bull* model.

The other category is one in which two taxes operate, in a given situation, interdependently in the sense that a determination that there is, for example, a deficiency in one tax pretty much automatically means that there is an overpayment of the other tax. That is to say, there is such a statutory interrelationship between the two taxes, that a determination with respect to that interrelationship for purposes of one tax will automatically produce the result as to the other tax. One example of such a statutory interrelationship, which we have already seen in connection with the "clean hands" doctrine,[176] is that of a pre-death income tax liability of a decedent being deductible as a claim against the estate for estate tax purposes.[177] In such a setting, an open pre-death income tax deficiency may automatically create a barred federal estate tax overpayment. This class of two tax cases will henceforth be referred to as the *Herring-Bowcut* model, so named for the lower court decisions,[178] to be discussed in detail later on, dealing with this precise statutory interrelationship.

B. Single Tax Cases

Less commonly, equitable recoupment may be available in the case of only a single type of tax, assuming that such tax is not an income tax. This would occur where specific taxable years or periods are not applicable, as for example, the federal estate tax, and there are two different taxpayers with a sufficient identity of interest.[179] It might also arise, theoretically, with different taxable periods and the same taxpayer.[180] Where the single tax implicated is income tax, however, statutory mitigation may have ousted equitable recoupment.[181] Thus, where income tax is involved for the same taxable period with two different taxpayers possessing an absolute identity of interest, as in *Stone v. White*, equitable recoupment is generally no longer available due to its preemption by statutory mitigation.[182]

The doctrine of equitable recoupment has now been placed in its correct relationship to statutory mitigation as well as to set off. Further, its general application today under the *Bull* and *Herring-Bowcut* models has been indicated. It is, therefore, time to summarize its main procedural features in that general application, with emphasis upon how the doctrine is properly to be invoked in the adversarial context.

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176. *See supra* text accompanying notes 133-38.

177. *See supra* note 134.

178. *See supra* note 135.

179. *E.g.*, Estate of Vitt v. United States, 706 F.2d 871 (8th Cir. 1983).

180. *See* Kolom v. United States, 791 F.2d 762 (9th Cir. 1986).

181. For a rare situation involving an income tax—the minimum tax on preference income—the same taxpayer and different taxable periods, where equitable recoupment was allowed because the facts did not come within any circumstance of adjustment, *see id.*; *supra* note 123.

182. *See* I.R.C. §§ 1312(5), 1313(c)(4); Note, *Equitable Recoupment in Tax Law*, 42 N.Y.U. L. Rev. 537, 546 & n.55 (1967).

The Principal Procedural Features of Equitable Recoupment: A Summary

In General

As to the substantive elements of the doctrine, the barred and open claims of the opposing parties result from inconsistent treatment of a single transaction, with the added qualification that, where different taxpayers are involved, an identity of interest must exist between them.

On the procedural side of things, it should be kept in mind that the doctrine is equally available to the taxpayer and the government. In that context, the claim of one party (either the taxpayer or the government) will be open while that of the other will be barred. Consequently, if the claim of the taxpayer for refund is barred, then the taxpayer will be seeking to equitably recoup that barred claim against the open deficiency being asserted by the government. But if the deficiency otherwise assertable by the government is barred, then it is the government that will be seeking to equitably recoup the barred deficiency against the open refund claim of the taxpayer.[183]

Doctrine Usable Only in Diminution of Opposing Open Claim

Under the doctrine of equitable recoupment, the barred claim is only usable to reduce or wipe out the open claim, but no more. That is to say, it merely operates as a "diminution of . . . [the] right to recover" on the open claim.[184] Otherwise, it would, in effect, permit the party asserting the barred claim full collection or recovery thereon, thereby completely undercutting the statutes of limitation. Thus, the government may utilize the barred deficiency to decrease or eliminate the open refund claim of the taxpayer, but not to produce a deficiency in respect to the open claim.[185] On the taxpayer's side, the barred refund right is available to decrease or eliminate the open tax liability asserted by the government, but not to cause a refund in regard to that open claim.[186] Most obviously, as the doctrine is usable by one party only to diminish the *other* party's right to recover, the taxpayer may not use a barred refund claim to increase the taxpayer's open refund claim. For the same reason, the government may not use a barred deficiency to increase the government's open deficiency claim.[187]

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183. *Compare* Bull v. United States, 295 U.S. 247 (1935) *with* Stone v. White, 301 U.S. 532 (1937).

184. Stone v. White, 301 U.S. 532, 539 (1937).

185. *See* O'Brien v. United States, 766 F.2d 1038, 1049 (7th Cir. 1985).

186. *Id.*, Evans Trust v. United States, 462 F.2d 521, 526 (Ct. Cl. 1972). It must be remembered, however, that, in the litigation context, equitable recoupment may only be raised in a refund suit forum and not in the United States Tax Court. *See supra* notes 92-105 and accompanying text. Therefore, in that setting and considering its assertion by the taxpayer, the doctrine could only be properly invoked, following the taxpayer's payment of the open deficiency asserted by the government, by a timely filed claim, and subsequent suit, for refund of part or all of that open deficiency payment. It follows that the taxpayer can use equitable recoupment to obtain a refund with respect to the open claim of the government. That refund, however, will only be an amount sufficient to reduce or wipe out the originally-asserted open deficiency and not anything greater.

187. *See supra* note 185.

Equitable Recoupment in Litigation

We have already seen that the United States Tax Court does not have jurisdiction to consider a claim of equitable recoupment.[188] Therefore, such claims may only be raised in a refund suit forum after payment of the tax.[189] Insofar as the government is concerned, it may raise the claim of equitable recoupment as a defense to the taxpayer's suit for refund on grounds other than equitable recoupment.[190]

As to the taxpayer, however, the claim of equitable recoupment will serve as the very basis or ground for the refund suit.[191] In this case, the taxpayer's claim for refund based upon equitable recoupment, constituting the foundation stone of the refund suit,[192] must be in regard to the open liability.[193] For example, on the facts of *Bull*, where there was a barred estate tax overpayment and an open income tax liability, the actual claim for refund (and subsequent refund suit) must be for the open income tax year in question. Thus, the refund claim must seek a return of income tax paid for the open income tax year[194] despite the fact that the reason behind the claim is the barred estate tax overpayment. Likewise, the income tax refund claim must be timely filed.[195]

Equitable Recoupment in I.R.S. Administrative Proceedings

The Service has ruled that a taxpayer may assert a claim of equitable recoupment in a proceeding before it,[196] apparently in the interest of administrative efficiency and economy. It would, therefore, be appropriate for the taxpayer to raise it during or following a Service-initiated audit in order to reduce or eliminate any otherwise resulting deficiency. It could also be raised before the Service by the filing of a claim for refund based upon that doctrine where the tax has already been paid.[197] If the latter, then the claim for refund must be in respect of the open liability and be timely filed.[198] Needless to say, where the taxpayer has filed a timely claim for refund on grounds other than equitable recoupment, the government may raise the de-

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188. *See supra* notes 92-105 and accompanying text.

189. *See supra* notes 2-4, 106-07 and accompanying text.

190. *See* Stone v. White, 301 U.S. 532, 534 (1937).

191. *See* Bull v. United States, 295 U.S. 247, 253 (1935).

192. The taxpayer generally may not sue for a refund on a ground different from that contained in a timely-filed claim for refund. United States v. Felt & Tarrant Mfg. Co., 283 U.S. 269 (1931). *See* Vishnevsky v. United States, 581 F.2d 1249, 1252-53 (7th Cir. 1978).

193. O'Brien v. United States, 766 F.2d 1038, 1049-50 (7th Cir. 1985). *See* Bull v. United States, 295 U.S. 247 (1935); United States v. Gulf Oil Corp., 485 F.2d 331 (3d Cir. 1973). *Contra,* Kolom v. United States, 791 F.2d 762, 767-68 (9th Cir. 1986). The Ninth Circuit is simply incorrect in this regard because if equitable recoupment is a permissible basis for a refund suit for the barred year rather than the open year, then it completely undercuts the statute of limitation. That this is true is evident from the fact that, in such case, it no longer operates merely to diminish the opposing party's right to recover, but, instead, is serving as an independent ground for obtaining a refund that is directly barred by a statute of limitation. *See supra* notes 183-86 and accompanying text.

194. *See supra* note 186.

195. *E.g.,* O'Brien v. United States, 766 F.2d 1038, 1049 n.13 (7th Cir. 1985); Evans Trust v. United States, 462 F.2d 521, 523, 526 (Ct. Cl. 1972); Rev. Rul. 71-56, 1971-1 C.B. 404.

196. Rev. Rul. 71-56, 1971-1 C.B. 404.

197. *See* Ltr. 8552005, Aug. 29, 1985, C.C.H. Letter Rulings Rep't No. 463, Jan. 15, 1986 (Part II).

198. *See supra* notes 192-95 and accompanying text.

fense of equitable recoupment in the Service's administrative proceeding.[199]

With that summary of the procedural features of the doctrine and how it may be properly invoked in mind, it is now appropriate to consider the various two tax aspects of modern-day equitable recoupment under the *Bull* and, more particularly, the *Herring-Bowcut* models in some detail.

THE TWO TAX ASPECTS OF EQUITABLE RECOUPMENT

The Bull *Model in General*

The traditional and most uncontroversial class of two tax cases to which the doctrine of equitable recoupment has been applied from its very beginnings are those where a single item of receipt, expenditure or other transaction is possibly subject to either of two different taxes, but not both. The reason for the uncontroversial nature of these cases within the *Bull* model is not only that they bear the imprimatur of the Supreme Court, but that this model possesses the same or single transaction, item or taxable event element of that doctrine. Statutes of limitation are obviously needed in order to avoid the problem of stale claims including the death of witnesses and loss of documents, memory and other evidence.[200] The effect of the conceded presence of the single transaction element in the *Bull* model of cases is, of course, that there is likely little or no significant problem of staleness. In other words, the facts in regard to the single transaction are pretty much known as the result of the open claim determination. On that basis alone it would seem that the use of equitable recoupment to negate the effect of the statutes of limitation is justified.[201]

Even more importantly, however, considering the *Bull* model of cases with its "either-or, but not both" tax context, the open determination that one tax is applicable means that the other tax was not, thereby automatically producing, or resulting in, the barred claim. In other words, there is really nothing left to be determined with respect to that barred claim. On this ground there is even less problem of staleness, and the application of equitable recoupment is all the more merited.

There are a number of different situations where cases within the ambit of the *Bull* model either have arisen or could arise in the future. It seems helpful to set out some of these examples in order to indicate the potentially broad scope and application of this traditional model.

The Bull *Model: Income Tax and Estate Tax*

The enactment of the concept of income and deductions in respect of a decedent has, no doubt, deprived *Bull v. United States* of its authority concerning its assumption that, on the merits, the single item (the estate's share of post-death partnership profits) could not properly be subjected to both

199. Ltr. 8441003, June 6, 1984, C.C.H. Letter Rulings Rep't No. 398, Oct. 17, 1984 (Part II).
200. *See supra* text accompanying note 76.
201. *See* Note, *Estoppel and Recoupment in Federal Taxation After the Revenue Act of 1938*, *supra* note 147, at 301-02.

estate and income taxation.[202] Nonetheless, the *Bull* model retains some force in the income and estate tax arena for purposes of equitable recoupment.[203]

For example, some items of expense are potentially deductible by an estate *either* for federal estate tax purposes *or* for federal income tax purposes (if a proper waiver of the right to deduct for federal estate tax purposes is timely filed), but not both.[204] Under this statutory scheme, in the view of the Service, there is apparently no basis upon which to deny the federal estate tax deduction if the waiver has not been filed. Thus, the interest paid on federal estate tax deferred under Code sections 6161 or 6166 is deductible as an administration expense under section 2053(a)(2) for federal estate tax purposes, assuming that the expense is allowable under local law, where no section 642(g) waiver has been filed. This is so despite the fact that the expense has already been deducted for income tax purposes, and the statute of limitation bars any assessment of an income tax deficiency.[205] In this setting it is possible to have an open federal estate tax overpayment and a barred income tax deficiency attributable to the erroneous income tax deduction without the filing of the waiver. The Service has ruled that the government may equitably recoup the barred income tax deficiency against the estate's open estate tax overpayment, the single item giving rise to both being the same interest payments.[206]

The Bull *Model: Gift Tax and Estate Tax*

The *Bull* model also has potential applicability in the area of gift and estate taxes, particularly where *inter vivos* transfers are invalid or otherwise incomplete. For example, where a prior transfer with payment of gift tax was later determined to be invalid due to the incompetency of the donor, no gift tax liability resulted. In addition, the property in question was includable in the donor's gross estate. This single event caused both a barred gift tax overpayment and an open estate tax liability. Noting that the estate was

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202. *See* M. FERGUSON, J. FREELAND & R. STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 213-15 (1970).

203. Something similar to the *Bull* model of equitable recoupment has been applied to dividend arrearages not within the concept of income in respect of a decedent but which have been subjected to excessive estate taxation (due to overvaluation) and also to income taxation in the hands of the beneficiaries who actually received payment. *See* Boyle v. United States, 355 F.2d 233 (3d Cir. 1965), *as modified in* 380 F.2d 973 (3d Cir. 1967); M. FERGUSON, J. FREELAND & R. STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 206-07 (1970).

204. *See* I.R.C. § 642(g). *Compare, e.g.*, I.R.C. §§ 162, 163, *with* I.R.C. §§ 2053(a)(2), 2054. This would include deductions for business expenses, interest and other items not accrued at the date of the decedent's death which would be allowable for federal estate tax purposes only as administration expenses. Treas. Reg. § 1.642(g)-2 (T.D. 6217, 12-19-56).

205. Rev. Rul. 81-287, 1981-2 C.B. 183. *See* Estate of Baldwin v. Comm'r, 18 T.C.M. 902, 953 (1959).

206. Rev. Rul. 81-287, 1981-2 C.B. 183; Ltr. 8429008, Apr. 5, 1984, C.C.H. Letter Rulings Rep't No. 386, July 25, 1984 (Part II); Ltr. 8409005 (No date given), C.C.H. Letter Rulings Rep't No. 366, Mar. 7, 1984 (Part II); Ltr. 8104187, Sept. 26, 1980, C.C.H. Letter Rulings Rep't No. 205, Feb. 5, 1981 (Part II), Ltr. 8104186, Apr. 30, 1980, C.C.H. Letter Rulings Rep't No. 205, Feb. 5, 1981 (Part II); Ltr. 8043003, Apr. 30, 1980, C.C.H. Letter Rulings Rep't No. 192, Nov. 5, 1980 (Part II); Ltr. 8043002, Apr. 25, 1980, C.C.H. Letter Rulings Rep't No. 192, Nov. 15, 1980 (Part II); Ltr. 8009018, Nov. 27, 1979, C.C.H. Letter Rulings Rep't No. 158, Mar. 12, 1980 (Part II); Ltr. 7928007, Mar. 29, 1979, C.C.H. Letter Rulings Rep't No. 124, July 17, 1979 (Part II).

liable under local law to repay the money originally borrowed to pay the alleged gift tax liability, the Service allowed equitable recoupment to the estate.[207]

Likewise, where a prior transfer of notes payable by the transferor on demand occurred and gift tax was paid, the transfer was not a completed gift as of the transferor's death because the notes had neither yet been paid nor transferred for value.[208] As an incomplete transfer, there was no gift tax liability. Furthermore, the notes were not deductible as a claim against the estate for federal estate tax purposes, presumably because they had not been given for consideration.[209] This single, incomplete transfer resulted in a barred gift tax overpayment and an open estate tax liability. Again, the Service allowed equitable recoupment to the estate.[210]

Another example where the *Bull* model could apply involves a post-1981 *inter vivos* transfer of an interest in property includable in the transferor's gross estate as a gift made within three years of death under sections 2035(a) and 2035(d)(2). In this case, any gift tax paid on that *inter vivos* transfer would also be includable in the gross estate.[211] If the transferor had erroneously paid the gift tax on that transfer in an earlier year when it was not yet a completed gift, and no gift tax would have been due for the year when it was a completed gift because of, for example, the annual exclusion,[212] then the transferor's estate may be entitled to a refund of the gift tax paid for the incorrect year. Thus, there may be a barred gift tax overpayment and an open estate tax liability. Equitable recoupment in favor of the estate seems justified here,[213] the single transaction being the *inter vivos* transfer. Although one might argue that this does not come strictly within the *Bull* model because the property transferred was subject to both gift and estate tax, this seems close enough for inclusion since there was no actual gift tax liability.

The Bull *Model: Income Tax and Excise Tax*

There are ramifications for this traditional model, too, in the field of income and excise taxes. For example, a foreign insurer will generally be subject to a federal excise tax on policies issued to United States policyholders based upon the amount of the premium,[214] unless it is engaged in a trade or business in the United States and is, therefore, subject to the income tax.[215] Consequently, a determination that a foreign insurer has been paying

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207. Ltr. 7921012, Feb. 8, 1979, C.C.H. Letter Rulings Rep't No. 117, May 31, 1979 (Part II). To similar effect, *see* Ltr. 7717001, Jan. 13, 1977, C.C.H. Letter Rulings Transfer Binder 7711001-7723036 (Part I) at 1139-42.

208. Rev. Rul. 67-396, 1967-2 C.B. 351, *clarified by* Rev. Rul. 84-25, 1984-7 I.R.B. 12.

209. *See* I.R.C. § 2053(a)(3) and (c)(1)(A); Treas. Reg. § 20.2053-4 (T.D. 6296, 6-23-58).

210. Ltr. 8205006, Oct. 26, 1981, C.C.H. Letter Rulings Rep't No. 258, Feb. 10, 1982 (Part III).

211. I.R.C. § 2035(c).

212. *See id.* § 2503(b).

213. *See* Ltr. 8215011, Dec. 29, 1981, C.C.H. Letter Rulings Rep't No. 268, Apr. 21, 1982 (Part II).

214. *See* I.R.C. § 4731.

215. *See id.* §§ 831, 842, 864. *Compare* Rev. Rul. 80-222, 1980-2 C.B. 211 (foreign insurer not engaged in trade or business in the United States, and not issuing policies signed or countersigned by an officer or agent in United States, is subject to the federal excise tax of section 4731(3)) *with* Rev.

income tax erroneously because it is not engaged in a trade or business in the United States and is, instead, subject to the federal excise tax, can create a barred income tax overpayment and an open excise tax liability. In such a case the Service has allowed equitable recoupment to the taxpayer.[216]

The Bull *Model: F.I.C.A./F.U.T.A. Taxes and R.R.T.A. Tax*

Finally, employment taxes can also be the setting for the invocation of equitable recoupment under the *Bull* model. An employer may be liable for the Federal Insurance Contributions Act (F.I.C.A.) and the Federal Unemployment Tax Act (F.U.T.A.) taxes on the one hand or Railroad Retirement Tax Act (R.R.T.A.) tax on the other, but not both.[217] Where an employer has been erroneously paying R.R.T.A. tax and erroneously not paying F.I.C.A./F.U.T.A. taxes, an open overpayment of the former and a barred deficiency of the latter may occur. In this context, the Service has allowed equitable recoupment to the government, the single transaction being the payment of wages by the taxpayer.[218] If the reverse were true, an open deficiency of R.R.T.A. tax and a barred overpayment of F.I.C.A./F.U.T.A. tax would justify equitable recoupment on behalf of the taxpayer for the same reason.[219]

Undoubtedly, then, the potential scope of application for the traditional *Bull* model of equitable recoupment is quite broad. It is at least as broad for the *Herring-Bowcut* model dealing with the other class of two tax cases.

The Herring-Bowcut *Model and the "Two Tax Effect"*

This category describes those two tax cases where there is such a statutory interrelationship between two different taxes that a determination with respect to that interrelationship for purposes of one tax can automatically produce the result as to the other tax. In other words, the two taxes operate interdependently in such a way that, what can be denominated today as the "two tax effect," is created.[220] A few examples of some of the areas where this model of equitable recoupment has been applied in the past or could arise in the future will convey at least a hint of the potential importance of this class of two tax cases.

The "Two Tax Effect:" Gift Tax and Estate Tax

This "two tax effect" has appeared in the gift and estate tax context by

Rul. 80-225, 1980-2 C.B. 318 (foreign insurer engaged in a trade or business in the United States is subject to income tax and not subject to excise tax under section 4731).

216. Ltr. 8342006, June 30, 1983, C.C.H. Letter Rulings Rep't No. 347, Oct. 26, 1983 (Part II).

217. I.R.C. §§ 3121(b)(9); 3231(a), (b), (c) & (d); Ltr. 8210004, Apr. 28, 1980, C.C.H. Letter Rulings Rep't No. 263, Mar. 17, 1982 (Part II). *See* Rev. Rul. 84-98, 1984-2 C.B. 304.

218. *See* Rev. Rul. 84-98, 1984-2 C.B. 304; Ltr. 8210004, Apr. 28, 1980, C.C.H. Letter Rulings Rep't No. 263, March 17, 1982 (Part II). The Code section allowing the cross-crediting of erroneous payments made under either Chapter 21 (F.I.C.A.) or Chapter 22 (R.R.T.A.) provides additional authority for this conclusion. *Id. See also* I.R.C. § 3503.

219. *Id.*

220. *See* Wilmington Trust Co. v. United States, 610 F.2d 703, 714 (Ct. Cl. 1979); Estate of Mann v. United States, 552 F. Supp. 1132, 1140-41 (N.D. Tex. 1982), *aff'd*, 731 F.2d 267 (5th Cir. 1984).

virtue of the fact that a pre-death federal gift tax liability of the decedent is deductible as a claim against the estate for federal estate tax purposes.[221] Therefore, an open pre-death gift tax deficiency can automatically create an estate tax overpayment which may be barred. In this case the Service has allowed equitable recoupment to the estate.[222] Based upon that position of the Service, it should also be allowed where the reverse is true. Thus, an open gift tax overpayment on behalf of the decedent by his estate, which overpayment has been deducted as a claim against the estate for estate tax purposes, can automatically result in an estate tax deficiency which may be barred. In this reverse situation, equitable recoupment in favor of the government would seem to be equally appropriate.[223]

The "Two-Tax Effect:" Income Tax and Excise Tax

The "two tax effect" has been frequently manifested in the interrelationship of the income tax with various federal excise taxes. For example, a corporation engaged in the business of rebuilding and selling automotive truck diesel engines was subject not only to the federal income tax but also to a federal excise tax, both taxes arising from the same transaction—the sale of these engines. Although the latter tax was not deductible for purposes of the former *as a tax*, it nonetheless constituted an income tax deduction as an ordinary and necessary business expense under section 162.[224] An open deficiency in excise tax, therefore, automatically created an income tax overpayment which, in this case, was barred. On these facts, the Service applied equitable recoupment in favor of the corporation.[225]

Likewise, a taxpayer may be entitled to an ordinary and necessary business expense deduction for insurance premiums paid to a foreign insurer.[226] Such payment may also be subject to the federal excise tax on policies issued by foreign insurers[227] and for which the taxpayer may be responsible.[228] If the payment of the alleged premium is not truly for insurance, however, but is actually something else, such as a capital contribution, then the taxpayer's deduction under section 162 may be disallowed for income tax purposes.[229] Such an open income tax deficiency (based upon there being no true insurance) can automatically cause an excise tax overpayment which may be barred. The Service has permitted equitable recoupment to the taxpayer on these facts.[230]

In view of that position of the Service, another illustration of a statutory interrelationship which could give rise to the application of equitable recoup-

221. I.R.C. § 2053(a)(3); Treas. Reg. §§ 20.2053-1(a)(1)(iii), 20.2053-6(d) (T.D. 6296; 6-23-58).
222. Ltr. 7839131, July 3, 1978, C.C.H. Letter Rulings Rep't No. 83, Oct. 4, 1978 (Part II).
223. *See id.*
224. *See* Treas. Reg. § 1.164-2(f) (T.D. 6780, Dec. 21, 1964, 1965-1 C.B. 96, 99).
225. Ltr. 8333007, May 16, 1983, C.C.H. Letter Rulings Rep't No. 338, Aug. 24, 1983 (Part II).
226. Treas. Reg. § 1.162-1(a) (T.D. 6291, Apr. 3, 1958, 1958-1 C.B. 63, 64-65, republished in T.D. 6500, Nov. 25, 1960).
227. I.R.C. § 4371.
228. *Id.* § 4374; Treas. Reg. § 46.4374-1(a) (T.D. 7023, Jan. 24, 1970).
229. *See, e.g.*, Carnation Co. v. Comm'r, 640 F.2d 1010 (9th Cir. 1981); Rev. Rul. 77-316, 1977-1 C.B. 53.
230. Ltr. 8552005, Aug. 29, 1985, C.C.H. Letter Rulings Rep't No. 463, Jan. 15, 1986 (Part II). *See* Ltr. 8142019, June 29, 1984, C.C.H. Letter Rulings Rep't No. 243, Oct. 28, 1981 (Part II).

ment involves the Windfall Profit Tax on Domestic Crude Oil.[231] This tax is deductible for income tax purposes.[232] Accordingly, an open deficiency or overpayment of the windfall tax could automatically result in, respectively, a barred overpayment or deficiency in income tax, appropriately giving rise to equitable recoupment in favor of either the taxpayer or the government, as the case may be.[233] Potentially, the field of income and excise taxes would, indeed, seem to be an exceptionally fertile one for the future application of the doctrine.

The "Two Tax Effect:" Income Tax and Estate Tax

Another set of statutory interrelationships constituting the necessary foundation stones for this model of equitable recoupment involves the income tax and the estate tax. The first of these concerns income in respect of a decedent. The value of a right to receive income in respect of a decedent is usually includable in the decedent's gross estate for federal estate tax purposes.[234] If the decedent's estate were actually to receive that income subsequently, then such income would be subject to income tax in the hands of the estate.[235] In that event, the estate would be entitled to an income tax deduction under section 691(c)(1) for a proportionate part of the federal estate tax paid. In this setting, a determination that an open estate tax overpayment occurred can automatically result in an income tax deficiency, due to the effect of section 691(c)(1), which may be barred. The Service has allowed equitable recoupment to the government in such a case.[236] On the other hand, and for the same reason, an open estate tax deficiency can automatically cause an income tax overpayment which may be barred. In this latter situation, equitable recoupment in favor of the taxpayer appears equally merited.[237]

The classic example of equitable recoupment in this category of cases involving two interrelated taxes, however, arises from the fact that a predeath federal income tax liability of the decedent is deductible as a claim against the estate for federal estate tax purposes.[238] That was the statutory

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231. I.R.C. § 4986.

232. *Id.* § 164(a)(5). *See id.* § 162(a).

233. *See supra* note 230.

234. I.R.C. § 2033. For some exceptions, *see* S. SURREY, W. WARREN, P. MCDANIEL AND H. GUTMAN, FEDERAL WEALTH TRANSFER TAXATION: CASES AND MATERIALS 139-40 (2d ed. 1982).

235. I.R.C. § 691(a)(1)(A).

236. Ltr. 8441003, June 6, 1984, C.C.H. Letter Rulings Rep't No. 398, Oct. 17, 1984 (Part II). *See* Kramer v. United States, 406 F.2d 1363, 1371 (Ct. Cl. 1969).

237. *See* Evans Trust v. United States, 462 F.2d 521, 526 (Ct. Cl. 1972).

238. I.R.C. § 2053(a)(3); Treas. Reg. §§ 20.2053-1(a)(1)(iii) (1958); 20.2053-6(a), (f) (first sentence) (1958). The opposite of this situation is where the decedent, at the time of his death, possessed a federal income tax refund claim for a pre-death year, and such claim was improperly not included in his gross estate for federal estate tax purposes. I.R.C. §§ 2031(a), 2033. In this case, there may be an open income tax overpayment and a barred estate tax deficiency, and the issue is whether the government will be allowed equitable recoupment.

It should be noted that, although this set of facts does involve a statutory interrelationship, it does not fit neatly within the *Herring-Bowcut* model. This is due to the fact that the determination with respect to the existence and amount of the open income tax overpayment does not, necessarily, automatically fix the amount of the barred estate tax deficiency. The reason is that the pre-death year income tax refund claim is generally includable in the gross estate only at its fair market value context in which *United States v. Herring*[239] and *United States v. Bowcut*[240] arose, and after which this *Herring-Bowcut* model of two tax cases is named. It is to these cases that we must now generally turn in order to seek a clearer grasp of the issues involved and the potential scope of equitable recoupment in its modern-day application.

The Herring-Bowcut *Cases: The General Problem and How It May Arise*

Both *Herring* and *Bowcut* presented the issue whether the taxpayer estate would be allowed to equitably recoup a barred estate tax overpayment against an open pre-death income tax liability of the decedent. At first blush, this might not appear a problem of much significance in federal taxation due to the normal chronology of events in such a situation. Thus, we obviously have a pre-death income tax liability and a post-death estate tax return (and payment) generally due within nine months after the decedent's death.[241] One would ordinarily expect that the liability that is first in time would become barred prior to those arising later in time. That would be true at least where, in the particular circumstances, the general assessment and refund claim statutes of limitation are essentially co-terminous, both basically expiring three years after the return in question was filed.[242] Consequently, the assessment of a pre-death income tax deficiency would normally become barred before the overpayment of estate tax created thereby would become barred.

This usual chronology of events may get out of order, however, in a number of different situations with the result that the post-death estate tax overpayment can become barred before the pre-death income tax deficiency. This may occur, for example, where no income tax return for a pre-death

as of the date of death, and the final determination of the precise amount of the actual income tax refund does not retroactively fix the fair market value of that claim as of the earlier date of death. *E.g.*, United States v. Simmons, 346 F.2d 213, 218 (5th Cir. 1965); Bank of California, Nat'l Ass'n v. Comm'r, 133 F.2d 428, 432-33 (9th Cir. 1943); Estate of Barneson v. Comm'r, 4 T.C.M. 427 (1945). Therefore, despite the final income tax refund determination, something more must be done before the amount of the barred estate tax deficiency can be fixed. The question becomes whether that something more—determining the fair market value of the income tax refund claim as of the date of death—is enough to prevent the application of equitable recoupment. In a sense, at least, the *Bull* element of the same or single item, transaction or taxable event may be satisfied here because the facts constituting the basis of the income tax refund claim may be sufficient also to establish fair market value as of the date of death. If not, however, there is a staleness problem (loss of memory, witnesses, documentary evidence, etc.) with respect to the barred estate tax claim of the government. Courts differ as to whether equitable recoupment should be applied in favor of the government in this context. *Compare* First Nat'l Bank of Omaha v. United States, 565 F.2d 507, 518 & n.24 (8th Cir. 1977) (yes) *with* Estate of Mann v. United States, 552 F. Supp. 1132, 1141 (N.D. Tex. 1982), *aff'd*, 731 F.2d 267, 279 (5th Cir. 1984) (no). On balance, as recoupment is an equitable remedy, it would seem that the hindsight determination of the date of death fair market value should not be an insuperable barrier to the application of the doctrine, at least to a court with general equity powers and the historical characteristics of "flexibility" and the capacity for refined "adjustments and reconciliation between the public interest and private needs . . . ." *See* Hecht Co. v. Bowles, 321 U.S. 321, 329 (1944). This would seem especially true if the symmetry of the applicability of the doctrine, in respect to its equal availability to both the taxpayer and the government, is to be maintained. *See supra* notes 43, 183 and accompanying text.

239. 240 F.2d 225 (4th Cir. 1957).

240. 287 F.2d 654 (9th Cir. 1961).

241. I.R.C. §§ 6075(a), 6151(a).

242. *See supra* note 119.

year was filed, in which case assessment can be made at any time.[243] Likewise, where the decedent for a pre-death year improperly omitted from his gross income an amount greater than 25 percent of the gross income stated in that income tax return, assessment within six years after the filing of the return will be timely.[244] Moreover, the normal order of events can be disrupted by a simple agreement to extend the statute of limitation on assessment of income tax for a pre-death year.[245] And, as in the *Herring* and *Bowcut* cases themselves, where the pre-death year income tax deficiency is tainted with fraud, assessment can be made at any time.[246]

The Herring-Bowcut *Cases: Avoiding the Problem Without Resort to Equitable Recoupment*

Of course, it is possible for the taxpayer to avoid the problem, in at least some of the described situations, without having to resort to equitable recoupment. This can be accomplished by the timely filing of a protective claim for refund of the then-contingent estate tax overpayment at the first hint of danger that an open pre-death income tax deficiency may be asserted.[247] This is fine so long as the danger becomes apparent before any potential estate tax overpayment becomes barred.[248] It is clearly no solution, however, where the danger becomes known only after the limitations bar has fallen on the potential estate tax refund right. Thus, for example, the decedent's fraud in connection with a pre-death income tax year, or more than 25 percent omission from gross income for such a year, may result in the estate having no timely warning.[249] The protective claim as a viable solution may also be negated by lack of taxpayer knowledge of this device or inadvertence.[250] In any event, where the timely filing of a protective claim is either not possible or is otherwise thought not to constitute good strategy,[251]

243. I.R.C. § 6501(c)(3).
244. *Id.* § 6501(e)(1)(A).
245. *See id.* § 6501(c)(4).
246. *Id.* § 6501(c)(1).
247. *See, e.g.*, Kellog-Citizens Nat'l Bank v. United States, 330 F.2d 635 (Ct. Cl. 1964); First Nat'l Bank of Montgomery v. United States, 280 F.2d 818 (Ct. Cl. 1960); Holzer v. United States, 250 F. Supp. 875, 878 (E.D. Wis.), *aff'd per curiam*, 367 F.2d 822 (7th Cir. 1966); Rev. Rul. 71-56, 1971-1 C.B. 404. A protective refund claim has been defined as a ". . . claim . . . to protect a potential right to receive a refund contingent on the happening of a future event." M. SALTZMAN, *supra* note 7, ¶ 11.08[3] at 11-39. Where the amount is unknown or uncertain, the claim should be based upon the best available information. *Id.*
248. The protective refund claim can be more advantageous than equitable recoupment. This is so because equitable recoupment would only permit, at most, the barred estate tax overpayment to eliminate the open income tax deficiency, but not to recover any excess of the former over the latter. *See supra* notes 184-86 and accompanying text. The protective claim for refund of the estate tax overpayment, on the other hand, would generally permit the recovery of the full amount of the refund claim because it is timely filed. It would thus effectually achieve recovery of any such excess.
249. *See, e.g.*, United States v. Herring, 240 F.2d 225, 228 (4th Cir. 1957).
250. It should be remembered that some lack of diligence in the timely assertion of the taxpayer's refund right does not prevent the application of equitable recoupment. *See supra* notes 129-32 and *infra* notes 260-61 and accompanying text.
251. For example, the filing of a protective refund claim for a potential estate tax overpayment prior to the existence of any danger of an open pre-death income tax deficiency may be a red flag to the Service thereby creating the very danger that might otherwise never have existed. In addition, there has been recent judicial criticism of some protective claim filing as "unnecessary and obtrusive paperwork." Chertkof v. United States, 676 F.2d 984, 991 (4th Cir. 1982). For a discussion of the

then the taxpayer may be ultimately relegated to reliance upon equitable recoupment.

Having seen the presence of the *Herring-Bowcut* general problem despite the normal chronological order of events, and the fact that it can not always be resolved by the use of the protective refund claim device, it is now time to turn our attention to the specific details of those cases.

The Herring-Bowcut *Cases in Detail*

In *Herring*, the decedent-husband died on July 18, 1948, and the surviving wife as administratrix filed the federal estate tax return on July 12, 1949, paying the tax shown to be due. After a subsequent investigation, the Service proposed income tax deficiencies, civil fraud and delinquency penalties, plus interest, in the total amount of about $103,000 against both the surviving wife individually and against the estate for some 16 years immediately preceding the husband's death. That amount was formally assessed in October 1952, and was thereafter paid in installments.[252] As this assessed pre-death income tax liability greatly reduced the size of the estate, on October 24, 1954, the administratrix filed a refund claim for some $13,750 of the already-paid estate taxes. After the Service denied this estate tax claim due to the limitations bar, the administratrix then filed a timely refund claim in the same amount for the income taxes paid based upon equitable recoupment.

After that claim was rejected, the administratrix sued for refund which the district court granted under the authority of *Bull v. United States.* On appeal, the Fourth Circuit affirmed, holding that the same item or transaction element of *Bull* was, in practical effect, satisfied in this case.[253] The court reasoned that:

> The Government has asserted two claims against the monies of the estate that came into the hands of the administratrix—one on account of past due income taxes and the other on account of the estate tax due on the net estate, and it is impossible to determine the amount of the latter without making due allowance for the deduction caused by the former.[254]

The court also noted that there was even more cause to allow recoupment here than in *Bull* because in *Bull* the time for filing the estate tax refund claim had not expired when the income tax was assessed. Here, on the other hand, no such lack of diligence could be asserted against the administratrix because the estate tax refund was barred before the income tax was assessed.[255]

Some four years later the Ninth Circuit had the occasion to pass upon a

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duty of a fiduciary to file a protective claim for refund of estate taxes, *see* Swietlik v. United States, 779 F.2d 1306 (7th Cir. 1985), *reh'g denied* (1986).

252. The last installment payment was made on April 16, 1954. United States v. Herring, 240 F.2d 225 (4th Cir. 1957).

253. *Id.* at 225-26, 228.

254. *Id.* at 228.

255. *Id. See supra* note 27.

like situation in *United States v. Bowcut*.[256] The decedent died on August 8, 1952, and his former wife, as executrix, filed the federal estate tax return on June 11, 1953, paying tax of approximately $3,900. The Service subsequently proposed additional income tax liabilities, with interest and penalties (including civil fraud), in the total amount of about $52,200 for the pre-death years 1947 through 1950, against the decedent and his former wife. Following settlement negotiations, the total amount finally agreed to on May 4, 1956 was some $32,300 for taxes, penalties and interest, which was subsequently paid. Because the payment of that amount for the pre-death years reduced the taxable estate and entitled the estate to an estate tax refund, a claim therefore was filed on November 8, 1956. Following the rejection of that claim due to the limitations bar, a timely income tax refund claim was filed on May 29, 1957 founded upon equitable recoupment. After its denial by the Service, the estate sued for the income tax refund in the federal district court which allowed the recovery under *Bull v. United States*.[257]

At the district court level the government argued, *inter alia*, that equitable recoupment was not appropriate under *Bull* due to the asserted lack of the single transaction element. The district court, however, dismissed that contention on the ground that the same money was involved in both the income tax and the estate tax claims, relying on the Fourth Circuit's decision in *Herring*.[258] The government did not renew that argument on its appeal to the Ninth Circuit.[259]

Instead, at the appellate court level, in support of its contention that equitable recoupment should be denied, the government relied upon the estate's lack of diligence.[260] In other words, following the assessment of the agreed-to income tax liability on May 4, 1956, the executrix still had about a five week period in which to file the estate tax refund claim in timely fashion, but had failed to do so. The Ninth Circuit nonetheless affirmed, noting that the facts in *Bull*, where recoupment had been allowed, indicated that the estate there had also been guilty of failing to timely file for a similar time period.[261] The appellate court stated: "It is apparently not the diligence of the taxpayer as to his legal rights which controls, but rather the inequity of holding that, while the government's rights under a transaction continue unimpaired, its adversary's rights thereunder are barred by limitations."[262]

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256. 287 F.2d 654 (9th Cir. 1961).

257. *Id.* at 655-56.

258. Bowcut v. United States, 175 F. Supp. 218, 221-22 (D. Mont. 1959).

259. The Ninth Circuit did note that ". . . the taxpayer emphasizes that she is seeking to recover the overassessment of estate tax by recoupment from the very fund which, taken from the estate, had brought about the fact of overassessment." United States v. Bowcut, 287 F.2d 654, 656 (9th Cir. 1961). The court of appeals acknowledged, however, that, due to the government's abandonment of its single transaction argument, it was not necessary to decide that issue. *Id.* at 656 n.1.

260. As another defense to the equitable recoupment claim, the government had asserted the lack of clean hands due to the existence of civil fraud with respect to the pre-death income tax years. The Ninth Circuit, however, gave that contention short shrift. *See supra* notes 133-38 and accompanying text.

261. United States v. Bowcut, 287 F.2d 654, 657 (9th Cir. 1961).

262. *Id.*

The Herring-Bowcut *Model and the I.R.S.*

Prior to the *Herring* and *Bowcut* decisions, the Service had ruled in 1955 that it lacked authority to apply a barred federal estate tax overpayment against open pre-death income tax liabilities of the decedent.[263] The major reason for this, in the view of the Service, was that this setting lacked the single transaction or taxable event element of *Bull,* as further embellished by *Electric Storage Battery.*[264] Some sixteen years later the Service reversed itself in Revenue Ruling 71-56, accepting the logic of *Herring* and *Bowcut* and agreeing to apply equitable recoupment in that specific context.[265] In so doing, the Service also announced that it would permit taxpayers to raise such recoupment claims in its administrative proceedings rather than relegating them solely to court litigation for vindication.[266]

Although there is some indication that the Service had intended to apply this new stance rather narrowly,[267] that does not seem to have been its actual practice to the present date. As we have seen, the Service appears to have applied the doctrine in an even-handed fashion for the benefit of both the taxpayer and the government in a number of different contexts involving statutorily interrelated taxes outside the precise confines of Revenue Ruling 71-56. Thus, the Service has applied it to the gift and estate taxes,[268] income and excise taxes,[269] as well as income and estate taxes in the section 691(c) setting,[270] for purposes of issuing technical advice and private letter rulings. It seems fair to conclude that this relatively frequent practice of the Service indicates that it regards the doctrine as an instrument of fairness to taxpayer and government alike as well as constituting a useful administrative tool.

In any event, from at least the early 1960's until late 1979 the availability of equitable recoupment, at least in the precise *Herring-Bowcut* case situation, seemed fairly well-established law.[271] That conclusion was reinforced by the Service's acceptance of those cases and extension of them generally to the field of interrelated taxes from and after 1971. Then, in late 1979, the United States Court of Claims sitting *en banc,* disturbed this area with its *Wilmington Trust* decision,[272] to which we now turn.

Wilmington Trust Co. v. United States *in the Court of Claims*

In these federal income tax refund cases consolidated under the name of *Wilmington Trust Co. v. United States,* individual taxpayers named Carpenter and McMullan had been engaged with others in various aspects of land

263. Rev. Rul. 55-226, 1955-1 C.B. 469.
264. *Id.* at 470.
265. 1971-1 C.B. 404.
266. *Id.*
267. *See* C.C.H. Internal Revenue Manual-Audit, Part IV, Subsection-2, 4414.(13) (12-10-81) ("Because of the highly judgmental character of this subject, the doctrine of equitable recoupment may be applied in only those cases which fit the exact facts presented in Rev. Rul. 71-56.").
268. *See supra* note 222.
269. *See supra* notes 225 and 230.
270. *See supra* note 236.
271. The same holding by the Court of Claims in 1938, although of pre-*Electric Storage Battery* vintage, further supports this view. Dunigan v. United States, 23 F. Supp. 467 (Ct. Cl. 1938).
272. Wilmington Trust Co. v. United States, 610 F.2d 703 (Ct. Cl. 1979).

and forest management businesses. For income tax purposes, the taxpayers deducted certain timber operations and management expenditures against ordinary income on the ground that they properly constituted ordinary and necessary business expenses, instead of treating them merely as offsets against capital gain[273] (with lesser tax benefit due to the lower preferential rate) on the theory that they were only part of the selling expenses incurred in timber sales.[274] After these taxpayers died, the Service assessed income tax deficiencies against them for certain pre-death years based on the contention that the latter theory was correct. In each case, the estate of the decedent paid these deficiencies.[275]

Such pre-death income tax liabilities of a decedent constitute deductible claims against the estate for federal estate tax purposes.[276] The McMullan estate deducted them in timely fashion on its original estate tax return filed on December 10, 1973, and the Service allowed this after audit.[277] With respect to these pre-death income taxes it had paid, however, that estate subsequently timely filed a refund claim in July 1974 and, upon its denial, filed suit for refund in the Court of Claims on March 22, 1976.[278]

The Carpenter estate, represented by the Wilmington Trust Company, having already filed its original estate tax return on or before August 30, 1974 and paid the tax, timely sought an estate tax refund based upon the deduction of the pre-death income taxes paid. The Service subsequently allowed the estate tax refund. Meanwhile, the Carpenter estate likewise had sought a refund of these same pre-death income taxes it had paid, and by not later than December 1975 an income tax refund suit reflecting this claim was pending.[279]

In summary, both estates paid the pre-death income tax deficiencies in full based upon the Service's position that the timber operations and management expenditures could only be utilized as offsets against the capital gains from timber sales. Both estates then timely received the benefit of those payments as deductions for estate tax purposes, thereby reducing their respective estate tax liabilities. The estate chose, however, to litigate the merits of their decedents' pre-death income tax liabilities via the refund route in the Court of Claims, apparently believing that such timber operations and management expenditures were properly deductible against ordinary income as business expenses under favorable Court of Claims precedent.[280]

In this setting, it is obvious from the particular statutory interrelationship of the two taxes involved that, if the estates prevailed on the merits of their income tax refund suits, they would have actually deducted too much income tax for estate tax purposes, thereby automatically creating or result-

273. *See* I.R.C. §§ 631(b), 1221.
274. *See* Woodward v. Comm'r, 397 U.S. 572, 574-75 (1970).
275. *Wilmington Trust*, 610 F.2d at 704, 706-07, 710-11.
276. *See supra* note 134.
277. *Wilmington Trust*, 610 F.2d at 711.
278. *Id.* at 714-15.
279. *Id.* at 710.
280. *See* Union Bag-Camp Paper Corp. v. United States, 325 F.2d 730 (Ct. Cl. 1963); *Wilmington Trust*, 610 F.2d at 707.

ing in an estate tax deficiency. Measuring three years from the respective dates that the estate tax returns were filed, under the general assessment limitations statute[281] such a deficiency could be timely asserted by the Service against the McMullan estate until December 10, 1976 and against the Carpenter estate until August 30, 1977.[282]

It is, therefore, fair to say that the government was at least on notice of the need to protect itself concerning a potential estate tax deficiency caused by any adverse decision in the McMullan estate's income tax refund case from and after late March 1976 when suit was filed. Thus, the government had more than eight months warning prior to the expiration of the statute of limitation.[283] Likewise, in the Carpenter estate's income tax refund suit the government was on notice of this danger at least from and after December 1975, or substantially more than a year before the fall of the limitations bar.[284]

The government did not, however, assert its claims arising from any contingent estate tax deficiencies[285] until after the statute of limitation barred the direct assessment of those deficiencies.[286] By amended answers filed subsequent to the expiration of the limitations statute the government, instead, sought to offset the resulting estate tax deficiencies against any income tax refunds determined to be due, under the doctrine of equitable recoupment.[287] It was in this posture that these income tax refund suits came to, and were decided by, the Court of Claims.

On the merits of the substantive issue whether the timber operations and management expenditures were deductible against ordinary income as business expenses or allowable only as offsets against capital gain as selling expenses, the court determined that the former was correct and held for the taxpayers on that issue.[288] That holding then squarely presented the issue whether the government should be allowed to equitably recoup the resulting estate tax deficiencies that were barred against the open income tax refunds otherwise due to the estates.

On this issue also, the Court of Claims held for the taxpayers, denying equitable recoupment to the government on the ground that the single transaction element of *Bull*, as interpreted by *Electric Storage Battery*, was not satisfied.[289] Applying its understanding of the "limited scope" to be given recoupment in federal taxation after *Electric Storage Battery*,[290] the court stated:

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281. I.R.C. § 6501(a).
282. *See Wilmington Trust*, 610 F.2d at 711 n.7.
283. *Id.* at 714-15.
284. *See id.* at 714.
285. *See* United States Claims Court Rule 13. *See also* FED. R. CIV. P. 13.
286. Presumably, the government had sufficient notice to protect itself before the expiration of the statute of limitation on assessment of the estate tax deficiencies. For some alternative methods of protection, *see* McMullan v. United States, 686 F.2d 915, 924 (Ct. Cl. 1982).
287. *Wilmington Trust*, 610 F.2d at 711 & n.7. For some of the circumstances involved with respect to the McMullan estate tax return, *see* McMullan v. United States, 686 F.2d 915, 923 (Ct. Cl. 1982).
288. *Wilmington Trust*, 610 F.2d at 704, 707-10.
289. *Id.* at 711-15.
290. *Id.* at 713.

> The income tax refund is based upon the deductibility from ordinary income of the timber operations expenses. The estate tax deficiency, however, exists because the estate deducted the additional income taxes reflecting those expenses it had paid and now is recovering. The recoupment claim thus arises from a different transaction (the reduced deduction from the estate tax) than the refund claims (the increased deductions from ordinary income).[291]

The court then then proceeded to consider the "two tax effect" arising from the particular statutory interrelationship of the income and estate taxes here involved. The court said:

> The only sense in which these two claims could be said to arise out of a single transaction is that the determination that the timber expenses were deductible from ordinary income had an effect upon both the estate tax and the income tax. The fact that a single tax determination may affect the taxes on two transactions does not convert the two transactions into a single one. If such interdependency of separate claims is sufficient to make them arise out of the same transaction, the doctrine of equitable recoupment would be significantly extended beyond the "limited scope" the Supreme Court accorded it in . . . [*Electric Storage Battery*].[292]

Although it did not precisely delineate how this case presented any problem of staleness, the court noted generally that statutes of limitation are themselves overall instruments of fairness,[293] designed to protect litigants against stale claims.[294] Consequently, "an expansive application of equitable recoupment 'would seriously undermine the statute of limitations in tax matters.' "[295] Asserting further that, although "the courts have not specifically articulated the point,"[296] an additional consideration militating against the allowance of recoupment here was that the government had had "a fair opportunity to bring suit to recover the [estate] tax before the statute ran."[297] The court did not rely upon this lack of diligence by the government, however,[298] and perhaps wisely so,[299] instead basing its decision upon its single transaction analysis. The court concluded, therefore, that the estates should be allowed to recover the full amount of their income tax overpayments without diminution by reason of the barred estate tax deficiencies under the recoupment theory.[300]

291. *Id.* at 714.
292. *Id.*
293. *Id.* at 712, 714.
294. *Id.* at 712.
295. *Id.* at 714.
296. *Id.* This is simply an incorrect statement. *See infra* note 299.
297. *Wilmington Trust*, 610 F.2d at 714-15 (Ct. Cl. 1979).
298. *Id.* at 713 & n.10.
299. *See supra* notes 27, 129-32, 255, 260-62 and accompanying text.
300. For subsequent events with respect to the McMullan estate's suit for refund of the *1972* predeath income tax deficiency paid which had also been allowed as a federal estate tax deduction, *see* McMullan v. United States, 686 F.2d 915, 923-24 (Ct. Cl. 1982) (Government prevailed on theory of equitable estoppel, with respect to adjustment of income tax recovery by estate for resulting barred estate tax deficiency, due to assurances contained in letter from estate's attorney to the estate tax auditor, upon which government relied.) The earlier consolidated *Wilmington Trust* cases had only involved the 1969-71 income tax years with respect to the McMullan estate.

THE *HERRING-BOWCUT* MODEL AND *WILMINGTON TRUST*: SOME PRELIMINARY OBSERVATIONS

The ultimate question is whether the Court of Claims was correct, both as a matter of law and as a matter of policy, in its *Wilmington Trust* decision and its placement of the "two tax effect" beyond the pale of the single transaction element of the recoupment doctrine. In setting the stage for consideration of this matter, it is necessary to make some preliminary observations.

The Equivalence of Herring-Bowcut *and* Wilmington Trust

First, the situation illustrated by *Wilmington Trust* is really nothing more than the government's side of equitable recoupment in the same context as *Herring-Bowcut.* In *Herring-Bowcut,* the taxpayers did not timely assert the open pre-death income tax liabilities as estate tax deductions, and, therefore, sought to equitably recoup the barred estate tax overpayments against the open income tax liabilities. On the other hand, in *Wilmington Trust* the taxpayers did timely assert the open pre-death income tax liabilities as estate tax deductions and then proceeded to litigate the merits of the income tax liabilities via the refund route. When the taxpayers won on the substantive merits of their refund claims and thus became otherwise entitled to the open income tax overpayments, the reduced income tax deductions for estate tax purposes resulted in estate tax deficiencies which became barred. The government then sought to equitably recoup the barred estate tax deficiencies against the open income tax overpayments. Being opposite halves of the same apple, so to speak, and given the long-established *Herring-Bowcut* precedents on the taxpayer's side coupled with their acceptance by the Service, *Wilmington Trust's* denial of equitable recoupment to the government did nothing whatsoever to foster the symmetry of that doctrine with respect to its equal availability to taxpayer and government alike.[301]

Herring-Bowcut *and* Wilmington Trust: *Distinguished from* McEachern v. Rose *and* Rothensies v. Electric Storage Battery Co.

The second preliminary observation to be made is that nothing in the actual facts of either *McEachern v. Rose*[302] or *Rothensies v. Electric Storage Battery Co.,*[303] the two Supreme Court cases where recoupment was denied, required its denial in *Herring, Bowcut* or *Wilmington Trust.* In assessing the validity of that proposition one should remember that in all of the latter lower court cases the initially perceived open income tax liability automatically triggers the concomitant right to the estate tax deduction. This automatic feature arising from the statutory interrelationship of the two taxes is enhanced by the fact that the amount of any resulting estate tax error is essentially only a matter of mathematical calculation.[304]

There was no such automatic feature constituting the basis of the equi-

301. *See supra* notes 43, 183 and accompanying text.
302. *See supra* text accompanying notes 45-55.
303. *See supra* text accompanying notes 58-79.
304. The amount of the pre-death income tax liability is also the amount of the estate tax deduction as a claim against the estate. I.R.C. § 2053(a)(3); Treas. Regs. §§ 20.2053-1(a)(1)(iii), 20.2053-

table recoupment claim present, however, in *Electric Storage Battery*. In that case, an almost inherent automatic feature of the relationship of the two taxes to the taxpayer existed to some degree. In other words, the payment of excise tax would pretty much automatically produce an income tax deduction.[305] Consequently, the *open* overpayments of excise taxes for the years 1922-26, which were deducted for income tax purposes, would automatically give rise to *gross income* upon their being recovered in 1935. The open overpayments of excise taxes for 1922-26 did not, however, automatically cause the income tax *deficiency* for 1935. Rather, the failure of the taxpayer to include the refunded overpayments in gross income caused the deficiency. This latter failure was an independent, and separate event—a human omission to act which was not the automatic product of the statutory interrelationship of the two taxes. Moreover, the *barred* overpayments of excise taxes on storage battery sales for the earlier years 1919-22 were obviously separate and distinct from the open overpayment of excise taxes on such sales for the later years 1922-26.[306] It must not be forgotten that only the former barred overpayments were being urged as the basis for equitable recoupment. Accordingly, it seems clear that *Electric Storage Battery*, involving as it does two or more separate transactions without any automatic side effect between them to constitute the basis for the recoupment claim, is soundly distinguishable from *Herring*, *Bowcut* and *Wilmington Trust*.

Insofar as *McEachern* is concerned, given the fact that it dealt solely with income taxes and thus did not implicate two different taxes, it could have no automatic relationship in the sense discussed here. Hence, it is distinguishable on that ground alone.[307] The result of this analysis is that the actual facts of the two Supreme Court cases denying equitable recoupment do not require its denial in *Herring*, *Bowcut* or *Wilmington Trust*.

Having made these preliminary observations, the question remains whether the Court of Claims was correct in excluding the "two tax effect" cases epitomized by the *Herring-Bowcut* model from the permissible range of the "single transaction" element of *Bull*. Would the allowance of equitable recoupment in such cases really expand the doctrine impermissibly beyond the scope envisioned for it by the Supreme Court in *Bull* as interpreted by *Electric Storage Battery?* There are a number of reasons why the *Herring-Bowcut* result can reasonably be regarded as both legally correct and otherwise to be preferred over *Wilmington Trust* as a matter of policy. It is on these considerations that we must now focus our attention.

6(a), (f) (T.D. 6296; 6-23-58); Old Colony Trust Co. v. United States, 15 F. Supp. 417, 421 (D. Mass. 1936).

305. *See* I.R.C. § 162; Treas. Reg. § 1.164-2(f), (T.D. 6780, 12-21-64, 1965-1 C.B. 96, 99). In the specific context, given the initial assumption of taxpayer excise tax liability, the "ordinary" and "necessary" nature of the excise tax payment as an "expense" in the taxpayer's "business" does not seem to be subject to much dispute.

306. *See* Elliff v. United States, 57 A.F.T.R.2d (P-H) 86-1042 (D. Ore. 1986) (personal labor performed in one year a separate transaction from that performed by same taxpayer in another year).

307. As in the case of *Electric Storage Battery*, *McEachern* is also distinguishable on the basis that separate transactions were present. *See supra* text section SURVIVAL OF EQUITABLE RECOUPMENT AFTER *MCEACHERN* AND *ELECTRIC STORAGE BATTERY*, at 611.

Herring-Bowcut, Wilmington Trust *and the Single Transaction Element*

In *Wilmington Trust* a unanimous Court of Claims sitting *en banc* held, in denying the government's recoupment claim, that two separate transactions occurred. In the view of the court, the open income tax overpayment arose from the issue whether the timber operations and management expenditures were deductible from ordinary income as ordinary business expenses. To the contrary, the barred estate tax deficiency was due to the taxpayer being entitled only to a lesser income tax deduction for estate tax purposes. For the Court of Claims, the fact that the ultimate source of both the taxpayer's open income tax overpayment claim and the government's barred estate tax deficiency claim was the same—the deductibility of the timber operations and management expenditures from ordinary income—was not sufficient.

On the other hand, the Fourth Circuit in *Herring* had found the same transaction element of *Bull* satisfied, in practical effect. This was essentially because both tax claims involved the estate funds, and it was impossible to determine the amount of the estate tax due on the net estate without considering the deduction of the pre-death income tax liability.[308] In other words, "[t]he single transaction was the erroneous treatment as corpus [of] that part of the estate which should have been paid as income tax."[309] Paraphrasing this in the *Wilmington Trust* context of the government's recoupment claim, the single transaction was the erroneous treatment as a deductible claim against the estate of that part of the estate which should not have been paid as income tax.

Because the facts of the Supreme Court cases do not encompass the "two tax effect" produced by the type of statutory interrelationship illustrated by *Herring-Bowcut* and *Wilmington Trust*, it might be thought that either lower court view of the single transaction element is at least as reasonable as the other. But no matter how thinly or thickly one wishes to slice that *Bull* concept in order to interpret it narrowly or broadly, the proper resolution of this issue depends upon other factors. Even if one does not necessary accept the *Herring-Bowcut* application of the single transaction element *per se*, it may still be possible to regard those cases as coming within the proper scope of *Bull* for another reason. That reason is the automatic feature present in *Bull* as well as in *Herring-Bowcut*.

The Automatic Feature of Bull v. United States

Of the two Supreme Court cases that permitted equitable recoupment, only *Bull v. United States* involved two different taxes, estate and income, being inconsistently imposed on what was clearly a single item or transaction—the receipt by the estate of its share of post-death partnership profits.

308. *See supra* text accompanying note 254. For the comment of the Ninth Circuit on that aspect on *Bowcut*, *see supra* note 259.

309. Note, *Equitable Recoupment in Tax Law*, 42 N.Y.U. L. REV. 537, 549 (1967). For a persuasive argument why the interactive effect of the corporate income tax and the wartime excess profits tax on a taxpayer for a single year should be treated as a single taxable event, although the statute of limitation was not implicated, *see* Babcock & Wilcox Co. v. Pedrick, 212 F.2d 645, 650-52 (2d Cir. 1954) (Jerome Frank, Circuit Judge, dissenting).

In that case the taxpayer was allowed to equitably recoup the barred estate tax overpayment against the open income tax liability.[310]

Another obvious, but unemphasized, feature of *Bull*, however, was the *automatic* nature of its conclusion with respect to the barred estate tax refund claim of the taxpayer once the Court made its determination as to the open income tax claim of the government (being litigated in the setting of the taxpayer's income tax refund suit). That is, once the Court determined that the post-death partnership profits were properly subject to the income tax, it was pretty much automatic, in the circumstances of that case, that such profits had been improperly subjected to the estate tax.[311]

It is true that in *Bull* the government contended that the post-death partnership profits were properly taxable for both estate and income tax purposes, and the Court had to resolve that issue.[312] It should not be forgotten, however, that the Court decided this in connection with the government's open claim for income tax as to which there was concededly no direct statute of limitation problem (*i.e.*, no problem of staleness). After the Court had ruled in that open determination that such profits could not, in the particular circumstances, be both corpus and income to the estate and that it was properly income, then it was automatically not subject to estate tax.[313] In other words, the Supreme Court's decision with respect to the open income tax claim in *Bull* left nothing more to be determined with respect to the substantive merits of the barred estate tax claim.

Therefore, the significance of such an "either-or, but not both" type of tax applicability determination with respect to the open claim, as in *Bull*, is that the result with respect to the barred claim automatically follows. All the facts are already known concerning the latter, and the result is clear. That was also precisely the situation in *Herring-Bowcut* and *Wilmington Trust*. The very open determination of the additional pre-death income tax liabilities in the former, and the pre-death income tax overpayments in the latter, automatically caused, respectively, the barred estate tax overpayments and deficiencies. This was due, of course, to the statutory interrelationship of the two taxes where a pre-death income tax liability of the decedent is deductible as a claim against the estate for estate tax purposes.

Although not explicitly stated in *Bull*, it is at least reasonable to conclude that this automatic feature of *Bull* implicitly countenances the *Herring-Bowcut* result. That these cases present the legally correct result on the basis of precedent becomes even clearer when one briefly considers the reasons behind, and the purposes underlying, the tax statutes of limitation and the relationship of this automatic feature to them.

The Rationales for Tax Statutes of Limitation

Undoubtedly a number of different reasons underlie the presence of

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310. *See supra* text accompanying notes 17-27.
311. *See* Bull v. United States, 295 U.S. 247, 254-57 (1935).
312. *Id.*
313. At the time *Bull* was decided in 1935, the concept of income in respect of a decedent had not yet appeared in the statute. M. FERGUSON, J. FREELAND & R. STEPHENS, FEDERAL INCOME TAXATION OF ESTATES AND BENEFICIARIES 213 (1970).

statutes of limitation in the Internal Revenue Code, but the principal one, not unique to the field of federal taxation, is to prevent the litigation of *stale claims*, whether by the government or the taxpayer.[314] This is because the mere passage of time tends to obscure the facts concerning such claims through loss of memory, death of witnesses, loss of documentary evidence and the like as well as raising the danger of perjury.[315] In addition, the concept of final repose constitutes an important foundation stone for limitations, the idea that after a period of time things have to be brought to an end, that the consequences of certain actions must be cut off at some point.[316]

Other identifiable purposes of tax statutes of limitation include the need to enable the Service to keep relatively current in its administration of tax matters[317] and, from the taxpayer viewpoint, to assure that demands for tax will be at least approximate in time to the receipt of income from which to make payment.[318]

The Relationship of the Automatic Feature of Bull *to the Single Transaction Element of Equitable Recoupment and to the Purposes of Statutes of Limitation*

Given the foregoing reasons for the existence of tax limitation statutes, particularly that of preventing the litigation of stale claims, their relationship to the single transaction element of equitable recoupment, and to the automatic facet of *Bull*, quickly becomes apparent. The Supreme Court seemingly imposed the single transaction element of the doctrine because it helps avoid the very staleness problem against which limitations are principally directed. Where a single item, transaction or taxable event is under scrutiny in connection with the open claim of one party, the facts of such transaction relating to the barred claim of the other party are, almost by definition, the same or related and substantially known. Consequently, the single transaction concept helps ensure a minimal staleness problem.[319] Obviously, in such a situation the negation of a statute of limitation by the application of equitable recoupment is more palatable.

The same may be said of the automatic facet of *Bull* which is also present in *Herring-Bowcut* and *Wilmington Trust*. In each of these cases the determination of the open claim leaves little or no factual issue with respect to the barred claim, and, hence, no real problem of staleness exists. Unlike the justifiable fear voiced by the Court in *Electric Storage Battery*, here no search with respect to the barred claim is either invited or necessary as it is

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314. *See* REPORT OF A SUBCOMMITTEE OF THE COMMITTEE ON WAYS AND MEANS ON A PROPOSED REVISION OF THE REVENUE LAWS, H.R. 75th Cong., 3d Sess. 55 (1938), in 103 INTERNAL REVENUE ACTS OF THE UNITED STATES 1909-1950; LEGISLATIVE HISTORIES, LAWS AND ADMINISTRATIVE DOCUMENTS (B.D. Reams, Jr. ed. 1979).

315. Maguire, *supra* note 16, part 1, at 517; Clifford, *Mitigation provisions: Current problems and judicial inconsistencies*, 47 J. TAX'N 68, 70 (Aug. 1977).

316. *See Proceedings of the Seventh Tax Clinic of the American Bar Association*, 16 TAXES 663, 694 (Nov. 1938) ("Statutes of repose are necessary; business cannot be run without statutes of repose." Percy W. Phillips, Washington, D.C.).

317. Maguire, *supra* note 16, part 1, at 515-16.

318. *Id.* at 516.

319. *See* Note, *Estoppel and Recoupment in Federal Taxation After the Revenue Act of 1938*, 52 HARV. L. REV. 300, 301-02 (1938).

already automatically known.[320] Accordingly, equitable recoupment appears particularly appropriate.

The other purposes served by tax limitation statutes likewise do not seem to constitute much of a barrier to the application of the doctrine. Thus, enabling the Service to keep relatively current in its handling of tax controversies is not endangered here, the automatic feature relieving it of any need to examine the barred claim extensively. Instead, it simply permits the open claim ". . . to be examined in all its aspects . . ." as explained in *Electric Storage Battery*.[321] In addition, the taxpayer interest in the coordination of demands for tax with the receipt of income from which to pay it is not a concern where the taxpayer is seeking equitable recoupment and is, therefore, the party asserting the barred claim.

The concept of final repose also does not seem to be of overwhelming importance where the claim of one party may only be inchoate or not even exist until the determination concerning the open claim has occurred, at which time the former may already be barred. That was, after all, substantially the situation in *Herring*.[322] Unlike *Electric Storage Battery* where the barred excise tax overpayments had been collected over twenty years, and had been barred for sixteen years, prior to the time recoupment was sought and were, hence, "long dead," in our automatic context the two claims usually arise relatively approximate in time.[323] Therefore, to speak of final repose as a factor pointing toward the denial of equitable recoupment in the *Herring-Bowcut* and *Wilmington Trust* situation is really to make a mockery of that concept.

The Limitations on Statutes of Limitation as Instruments of Fairness

In its narrow construction of the single transaction element, the *Wilmington Trust* court relied heavily upon that part of the *Electric Storage Battery* opinion emphasizing the statute of limitation as an overall instrument of fairness despite the fact that it might produce hardship or inequity to either side in individual cases.[324] The Court of Claims, however, placed too much weight upon that aspect and not enough upon whether the limitations statute would truly be undermined by permitting equitable recoupment in the particular case before it. As we have seen, the underlying purposes of the statute of limitation would not be violated by such action in the *Wilmington Trust* setting.

It is undoubtedly true that such statutes are necessary as a practical matter and that they do promote justice and fairness in the generality of cases in our tax system. Nonetheless, there is nothing inherently admirable or praiseworthy in any resulting hardship or inequity to either side, however necessary it may be overall. It is not fair to allow either the taxpayer or the government to obtain a benefit in the form of either a refund of an overpay-

320. *See supra* text accompanying note 78.
321. *See supra* text accompanying note 72.
322. *See* United States v. Herring, 240 F.2d 225, 228 (4th Cir. 1957).
323. *See supra* note 320 and text accompanying note 79.
324. *See* Wilmington Trust Co. v. United States, 610 F.2d 703, 712-13, 714 (Ct. Cl. 1979); text accompanying notes 74-77, *supra*.

ment or collection of a deficiency in one tax, and then to escape the detrimental consequences of that same benefit with respect to the other tax which automatically follows. Accordingly, when such an individual case result may be avoided without violating the underlying purposes behind the limitations statute, equitable recoupment is most appropriate.[325] That was eminently the situation in *Wilmington Trust.*

For all of the foregoing reasons, the *Herring* and *Bowcut* decisions can be reasonably viewed as coming within the permissible paramaters of equitable recoupment as established by the Supreme Court cases and, hence, regarded as legally correct. Moreover, their result is much the better policy choice over that of *Wilmington Trust.* That conclusion should also be true for all two tax cases where such a statutory interrelationship between the two exists that the determination as to the open claim of one party automatically produces or results in the barred claim of the other.

Wilmington Trust Co. v. United States *and Choice of Forum*

However flawed the *Wilmington Trust* decision by the Court of Claims may be, it nevertheless makes the proper choice of forum crucial to a taxpayer seeking to avoid the limitations bar through the use of equitable recoupment in any case coming within the *Herring-Bowcut* model. We have already seen that the United States Tax Court lacks jurisdiction over equitable recoupment claims.[326] With the advent of *Wilmington Trust,* it is clear that any case presenting solely the "two tax effect" of the *Herring-Bowcut* model can not be successfully pursued under the doctrine of equitable recoupment in the United States Claims Court.[327] The bottom line for practitioners is that only the federal district court remains the appropriate forum for such cases generally.[328]

CONCLUSION

We have traced the doctrine of equitable recoupment in the field of federal taxation as first applied, and later developed, by the Supreme Court, and as fleshed out within those parameters by the lower courts. The effect of the

325. The statement made by several commentators, in advocating the enactment of those Code provisions mitigating the effect of the income tax statutes of limitation, is equally applicable here: ". . . blind worship of a legal institution is very dangerous both to the community and to the institution itself. Injustice results when even the wisest doctrine is pressed beyond its proper application, and obstinate persistence in such excess may cause a damaging rebellion against the doctrine as a whole." Maguire, *supra* note 16, part 1, at 517-18 n.28.

326. *See supra* text accompanying notes 90-109.

327. The Federal Courts Improvement Act of 1982 created the United States Claims Court which inherited substantially all of the jurisdiction formerly exercised by the United States Court of Claims. *See* Pub. L. No. 97-164, §§ 105(a), 133, 96 Stat. 27, 39-41 (April 2, 1982). The United States Claims Court will accept all published decisions of the United States Court of Claims as binding precedent unless and until modified by decisions of the Federal Circuit Court of Appeals or the United States Supreme Court. General Order No. 1(1), United States Claims Court, October 7, 1982. The United States Claims Court will, therefore, treat the *Wilmington Trust* decision as binding.

328. Of course, if the taxpayer wishes to litigate the nonrecoupment merits of the federal tax controversy via the refund route and, at the same time, avoid the danger of equitable recoupment by the government in the *Herring-Bowcut* model context, then the United States Claims Court is clearly the appropriate forum after *Wilmington Trust.*

doctrine, which permits a barred claim of either the taxpayer or the government to reduce or wipe out the open claim of the other, respectively, is to negate or avoid the applicable statute of limitation to that extent. Its principle elements have traditionally been regarded as requiring that (1) the same or a single transaction, item or taxable event, (2) be subjected to inconsistent treatment, and (3) where more than one taxpayer is involved, an identity of interest must exist between them.

Having first distinguished it from the judicially created doctrine of set off as well as from the mitigation provisions of the Code dealing solely with income taxes, we have seen that the doctrine may only be raised in a refund suit forum and not in the prepayment forum. Thus, equitable recoupment may be raised in either the appropriate federal district court or the United States Claims Court, but not in the United States Tax Court. This is because the Tax Court lacks general equitable jurisdiction. Equitable recoupment is equally available to either the taxpayer or the government. Therefore, on the taxpayer's side, the barred claim would serve as a basis of the refund suit for an open overpayment of tax. On the government's side, the barred claim could be asserted as a defense to the taxpayer's refund suit on other grounds. In addition, the Service allows the doctrine to be raised by either party in its proceedings as a matter of efficiency and administrative convenience.

The modern-day thrust of the doctrine is principally in the area where two different taxes are involved, at least one of which is not income tax. In this context there are two classes of cases. The first and traditional category, modeled after *Bull v. United States*, is where a single item of receipt, expenditure or other transaction is potentially subject to one of two taxes, but not both. The second category is where the determination of the open claim of either the taxpayer or the government automatically produces or results in the barred claim, respectively, of the other due to the statutory interrelationship or interdependency of the two taxes. For illustrative purposes, this model has been named after *United States v. Herring* and *United States v. Bowcut*. These lower court decisions allowed the use of equitable recoupment in the situation where the determination of the open deficiency in predeath income tax automatically resulted in the barred estate tax overpayment due to the deductibility of the former as a claim against the estate for purposes of the latter.

The *Herring-Bowcut* cases appear to have received the sanction of time, if not the explicit imprimatur of the Supreme Court, at least as to the use of equitable recoupment on the basis of the precise statutory interrelationship there involved. This is due to their having been on the books for approximately twenty years up to the advent of *Wilmington Trust* and also because of their acceptance and use by the Service for a decade and a half, both before and after that advent, up to the present time.

The Court of Claims, however, sitting *en banc* in *Wilmington Trust*, denied the use of equitable recoupment on facts equivalent to *Herring-Bowcut*, narrowly interpreting the single transaction element which it believed to be in keeping with the "limited scope" accorded that doctrine by the Supreme Court in *Electric Storage Battery*. This article has shown that the Court of Claims in arriving at its decision, however understandably, placed too much emphasis on the single transaction element of *Electric Storage Battery* and too little upon the purposes behind statutes of limitation and whether they would be undercut in the particular situation. In the *Wilmington Trust* case, as in *Herring-Bowcut,* the reasons supporting the limitations statute would not be undermined by the granting of equitable recoupment. Moreover, the heretofore little-discussed but important automatic feature of *Bull v. United States* provides a plausible and consistent basis for bringing the facts of *Wilmington Trust* within the legitimate parameters of that doctrine. Consequently, it is certainly reasonable to view that case as not beyond the pale of the permissible range of equitable recoupment as set out by the high court. Finally, one of the unfortunate practical consequences of *Wilmington Trust* is to place a premium on the correct choice of forum by the taxpayer in litigating cases coming within the *Herring-Bowcut* model.[329] Therefore, it is to be hoped that the Court of Claims decision in *Wilmington Trust* will be short-lived.

From a broader perspective, the doctrine can be seen as providing a necessary element of fairness to an Internal Revenue Code which seemingly imposes an ever-increasing number of different taxes in a society (with a sometimes-faltering economy) which is becoming more sophisticated and complex with every passing day. It should not be forgotten that the statutory mitigation provisions of the Code apply solely to income taxes and that Congress believed that other areas would not yield easily to such a statutory solution.[330] Consequently, by indicating that statutory mitigation was only intended ". . . to supplement the equitable principles applied by the courts . . . ,"[331] it seems clear that the legislative drafters envisioned the continuing role of equitable recoupment. Although that role may be somewhat broader than originally thought, at least partly due to the proliferation of taxes in the Code and their statutory interrelationships, it is nonetheless plausibly supported by the existing case law in the Supreme Court—specifically, *Bull v. United States* with its automatic attribute. Indeed, the very existence of the automatic prerequisite for the application of equitable recoupment in the context of the *Herring-Bowcut* model serves to ensure that the doctrine will remain limited in scope, as envisioned by the Supreme Court in *Electric Storage Battery.* Moreover, that broader but still limited role is justified as a matter of policy by our analysis of the reasons for tax statutes of limitation and their non-application here. Administratively, it also supported by the Service's acceptance of *Herring-Bowcut* in 1971 and its practice in recent years of applying the doctrine in a number of diverse and new situations.[332] Finally, it is impelled by the need to prevent overreaching, either by the government or by the taxpayer, in those areas of federal tax cases implicating the *Herring-Bowcut* model. Thus, equitable recoupment

329. *See supra* note 328 and accompanying text; Rothensies v. Electric Storage Battery Co., 329 U.S. 296, 303 (1946).

330. *See* Maguire, *supra* note 16, part 2, at 775.

331. *See* S. REP. No. 1567, 75th Cong., 3d Sess. 49 (1938), *in* 103 INTERNAL REVENUE ACTS OF THE UNITED STATES 1909-1950; LEGISLATIVE HISTORIES, LAWS AND ADMINISTRATIVE DOCUMENTS (B.D. Reams, Jr. ed. 1979).

332. *See, e.g.,* Ltr. 8552005, Aug. 29, 1985, CCH Letter Rulings Rep't No. 463, Jan. 15, 1986 (Part II).

should be available in any case involving two different taxes (one of which is not income tax) where the statutory interrelationship is such that the determination of the open claim of one party automatically produces or results in the barred claim of the other.