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**From:**
**Sent:** Wednesday, July 22, 2009 3:14:59 PM
**To:**
**Cc:**
**Subject:** FW: Disqualification of a Profit Sharing Plan

Below is an e-mail answer to using the duty of consistency. Thus, it appears from the response we will not be able to argue the duty of consistency in this case.

For your info also attached is Estate of Ashman v. Commissioner, 231 F.3d 541 (9th Cir. 2000) that is cited in the E-mail.

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**From:**
**Sent:** Wednesday, July 22, 2009 12:11 PM
**To:**
**Cc:**
**Subject:** FW: Disqualification of a Profit Sharing Plan

Here is our analysis on the duty of consistency issue. Please let me know if you need anything further from us or if you need this put into a formal memo.

**Facts**: Taxpayer made rollover contributions to the Profit Sharing Plan. These contributions occurred as early as and were reported on the Plan's Form 5500 and the taxpayer's individual return. The Service is asserting that the plan is disqualified because it violated the exclusive benefit rule and did not meet the qualification requirements of I.R.C. sec. 401(a)(1). The Service further asserts that this disqualification took place in (although the issue of possible disqualification in has been raised). Taxpayer's representative argues that if the disqualification is retroactive, the three year statute of limitation applies because the plan should have been disqualified prior to . This would result in the taxpayer avoiding income taxes on the rollover amounts. The taxpayer's representative believes that either: (a) the plan is not disqualified in any year prior to ; or (b) the plan was disqualified in a year now closed by the statute of limitations, i.e., prior to .

**Issue:** May the Service argue that the duty of consistency applies against the taxpayer because the Service did not have sufficient information or reason to disqualify the plan and the taxpayer was not forthcoming with such information.

**Answer**:

The duty of consistency is an affirmative defense that prevents a party, usually the taxpayer, from taking a tax position with respect to a tax year and then taking a contrary position in a subsequent year. The three elements of duty of consistency are: (1) a party makes a representation for tax purposes; (2) the other party acquiesces to the representation and relies on it; and (3) the first party changes the representation in a later year after the statute of limitations bars an adjustment to the initial year. Estate of Letts v. Commissioner, 109 T.C. 290 (1997). The duty of consistency may only be used for questions involving fact or for mixed questions of law and fact. It can't be used to prohibit an argument on a pure question of law. Crosley Corp. v. United States, 229 F.2d 376 (6th Cir. 1956).

In this case, the taxpayer and the plan made representations to the Service that rollover contributions were made to the plan in years prior to . The Service accepted those representations and relied on them. Neither the taxpayer, nor the plan, are now changing those representations. It is my understanding that they still believe those rollover contributions were valid, but if the Service determines they were not, the taxpayer would be liable for tax in those years. If the three year period of limitations applies, any assessment of tax for those years is now barred by the statute of limitations.

Whether those rollover contributions were valid appears to be a pure question of law. The taxpayers are not changing any of the factual representations they previously made on their returns. The sole question is whether, under the facts as provided by the taxpayer and discovered by the Service, the plan is disqualified under the Code. Since this question is a question of law, the duty of consistency may not be applied. Cf. Estate of Ashman v. Commissioner, 231 F.3d 541 (9th Cir. 2000) (taxpayer bound by the duty of consistency after she incorrectly stated on her return that she had rolled over plan distribution within 60 days of distribution).