

Example 2. B has ordinary farm income of \$200,000 and ordinary nonfarm losses of \$50,000. B's taxable income is \$150,000 (\$200,000 - \$50,000). B's electible farm income is \$150,000, all of which is ordinary income.

Example 3. C has a farm capital gain of \$50,000 and a nonfarm capital loss of \$40,000. C also has ordinary farm income of \$60,000. C has taxable income of \$70,000 (\$50,000 - \$40,000 + \$60,000). C's electible farm income is \$70,000. C can elect to average up to \$10,000 of farm capital gain and up to \$60,000 of farm ordinary income.

Example 4. D has a nonfarm capital gain of \$40,000 and a farm capital loss of \$30,000. D also has ordinary farm income of \$100,000. D has taxable income of \$110,000 (\$40,000 - \$30,000 + \$100,000). D's electible farm income is \$70,000 (\$100,000 ordinary farm income minus \$30,000 farm capital loss), all of which is ordinary income.

Example 5. E has a nonfarm capital gain of \$20,000 and a farm capital loss of \$30,000. E also has ordinary farm income of \$100,000. E has taxable income of \$97,000 (\$20,000 - \$23,000 (\$30,000 loss limited by section 1211(b)) + \$100,000). E has a farm capital loss carryover of \$7,000 (\$30,000 - \$23,000 allowed as a deduction). E's electible farm income is \$77,000 (\$100,000 ordinary farm income minus \$23,000 farm capital loss), all of which is ordinary income.

(f) *Miscellaneous rules*—(1) *Short taxable year*—(i) *In general.* If a base year or an election year is a short taxable year, the rules of section 443 and the regulations thereunder apply for purposes of calculating the section 1 tax.

(ii) *Base year is a short taxable year.* If a base year is a short taxable year, elected farm income is allocated to such year for purposes of paragraph (a)(2) of this section after the taxable income for such year has been annualized.

(iii) *Election year is a short taxable year.* In applying paragraph (a)(2) of this section for purposes of determining tax computed on the annual basis (within the meaning of section 443(b)(1)) for an election year that is a short taxable year—

(A) The taxable income and the electible farm income for the year are annualized; and

(B) The taxpayer may designate all or any part of the annualized electible farm income as elected farm income.

(2) *Changes in filing status.* An individual is not prohibited from making a farm income averaging election solely because the individual's filing status is

not the same in an election year and the base years. For example, an individual who files married filing jointly in the election year, but filed as single in one or more of the base years, may still elect to average farm income using the single filing status used in the base year.

(3) *Employment tax.* A farm income averaging election has no effect in determining the amount of wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (Federal income tax withholding), or the amount of net earnings from self-employment for purposes of the Self-Employment Contributions Act (SECA).

(4) *Alternative minimum tax.* A farm income averaging election does not apply in determining the section 55 alternative minimum tax for any base year or the section 55(b) tentative minimum tax for the election year or any base year. The election does, however, apply in determining the regular tax under sections 53(c) and 55(c) for the election year.

(5) *Unearned income of minor child.* In an election year, if a minor child's investment income is taxable under section 1(g) and a parent makes a farm income averaging election, the tax rate used for purposes of applying section 1(g) is the rate determined after application of the election. In a base year, however, the tax on a minor child's investment income is not affected by a farm income averaging election.

(g) *Effective date.* The rules of this section apply to taxable years beginning after December 31, 2001, except with respect to the written agreement requirement of paragraph (b)(2) of this section.

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READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

MITIGATION OF EFFECT OF LIMITATIONS AND OTHER PROVISIONS

§ 1.1311(a)-1 Introduction.

(a) Part II (section 1311 and following), subchapter Q, chapter 1 of the

§ 1.1311(a)-2

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Code, provides certain rules for the correction of the effect of an erroneous treatment of an item in a taxable year which is closed by the statute of limitations or otherwise, in cases where, in connection with the ascertainment of the tax for another taxable year, it has been determined that there was an erroneous treatment of such item in the closed year.

(b) In most situations falling within this part the correction of the effect of the error on a closed year can be made only if either the Commissioner or the taxpayer has taken a position in another taxable year which is inconsistent with the erroneous treatment of the item in the closed year. If a refund or credit would result from the correction of the error in the closed year, then the Commissioner must be the one maintaining the inconsistent position. For example, if the taxpayer erroneously included an item of income on his return for an earlier year which is now closed and the Commissioner successfully requires it to be included in a later year, then the correction of the effect of the erroneous inclusion of that item in the closed year may be made since the Commissioner has maintained a position inconsistent with the treatment of such item in such closed year. On the other hand, if an additional assessment would result from the correction of the error in the closed year, then the taxpayer must be the one maintaining the inconsistent position. For example, if the taxpayer deducted an item in an earlier year which is now closed and he successfully contends that the item should be deducted in a later year, then the correction of the effect of the erroneous deduction of that item in the closed year may be made since the taxpayer has taken a position inconsistent with the treatment of such item in such earlier year.

(c) There are two special circumstances which fall within this part but which do not require that an inconsistent position be maintained. One of these circumstances relates to the inclusion of an item of income in the correct year and the other relates to the allowance of a deduction in the correct year. In the first situation, if the Commissioner takes the position by a defi-

ciency notice or before the Tax Court that an item of income should be included in the gross income of a taxpayer for a particular year and it is ultimately determined that such item was not so includible, then such item can be included in the income of the proper year if that year was not closed at the time the Commissioner took his position. In the second situation, if the taxpayer claims that a deduction should be allowed for a particular year and it is ultimately determined that the deduction was not allowable in that year, then the taxpayer may take the deduction in the proper year if that year was not closed at the time the taxpayer first claimed a deduction.

[T.D. 6500, 25 FR 12031, Nov. 26, 1960]

§ 1.1311(a)-2 Purpose and scope of section 1311.

(a) Section 1311 provides for the correction of the effect of certain errors under circumstances specified in section 1312 when one or more provisions of law, such as the statute of limitations, would otherwise prevent such correction. Section 1311 may be applied to correct the effect of certain errors if, on the date of a determination (as defined in section 1313(a) and the regulations thereunder), correction is prevented by the operation of any provision of law other than sections 1311 through 1315 and section 7122 (relating to compromises) and the corresponding provisions of prior revenue laws. Examples of provisions preventing such corrections are sections 6501, 6511, 6532, and 6901 (c), (d) and (e), relating to periods of limitations; section 6212(c) and 6512 relating to the effect of petition to the Tax Court of the United States on further deficiency letters and on credits or refunds; section 7121 relating to closing agreements; and sections 6401 and 6514 relating to payments, refunds, or credits after the period of limitations has expired. Section 1311 may also be applied to correct the effect of an error if, on the date of the determination, correction of the error is prevented by the operation of any rule of law, such as *res judicata* or *estoppel*.

(b) The determination (including a determination under section 1313 (a)(4)) may be with respect to any of the taxes imposed by subtitle A of the Internal