

§ 1.1312-6 Correlative deductions and credits for certain related corporations.

(a) Paragraph (6) of section 1312 applies if the determination allows or disallows a deduction (including a credit) to a corporation, and if a correlative deduction or credit has been erroneously allowed, omitted, or disallowed in respect of a related taxpayer described in section 1313(c)(7).

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

Example 1. X Corporation is a wholly-owned subsidiary of Y Corporation. In 1955, X Corporation paid \$5,000 to Y Corporation and claimed an interest deduction for this amount in its return for 1955. Y Corporation included this amount in its gross income for 1955. In 1958, the Commissioner asserted a deficiency against X Corporation for 1955, contending that the deduction for interest paid should be disallowed on the ground that the payment was in reality the payment of a dividend to Y Corporation. X Corporation contested the deficiency, and ultimately in June 1959, a final decision of the Tax Court sustained the Commissioner. Since the amount of the payment is a dividend, Y Corporation should have been allowed for 1955 the corporate dividends-received deduction under section 243 with respect to such payment. However, the Tax Court's decision sustaining the deficiency against X Corporation occurred after the expiration of the period for filing claim for refund by Y Corporation for 1955. An adjustment is authorized with respect to Y Corporation for 1955.

Example 2. Assume the same facts as in example (1) except that, instead of the Commissioner asserting a deficiency against X Corporation for 1955, Y Corporation filed a claim for refund in 1958, alleging that the payment received in 1955 from X Corporation was in reality a dividend to which the corporate dividends-received deduction (section 243) applies. The Commissioner denied the claim, and ultimately in June 1959, the district court, in a final decision, sustained Y Corporation. Since the amount of the payment is a dividend, X Corporation should not have been allowed an interest deduction for the amount paid to Y Corporation. However, the district court's decision sustaining the claim for refund occurred after the expiration of the period of limitations for assessing a deficiency against X Corporation for the year 1955. An adjustment is authorized with respect to X Corporation's tax for 1955.

[T.D. 6617, 27 FR 10823, Nov. 7, 1962]

§ 1.1312-7 Basis of property after erroneous treatment of a prior transaction.

(a) Paragraph (7) of section 1312 applies if the determination establishes the basis of property, and there occurred one of the following types of errors in respect of a prior transaction upon which such basis depends, or in respect of a prior transaction which was erroneously treated as affecting such basis:

(1) An erroneous inclusion in, or omission from, gross income, or

(2) An erroneous recognition or non-recognition of gain or loss, or

(3) An erroneous deduction of an item properly chargeable to capital account or an erroneous charge to capital account of an item properly deductible.

(b) For this section to apply, the taxpayer with respect to whom the erroneous treatment occurred must be:

(1) The taxpayer with respect to whom the determination is made, or

(2) A taxpayer who acquired title to the property in the erroneously treated transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title in such a manner that he will have a basis ascertained by reference to the basis in the hands of the taxpayer who acquired title to the property in the erroneously treated transaction, or

(3) A taxpayer who had title to the property at the time of the erroneously treated transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1015(a) (relating to the basis of property acquired by gift).

No adjustment is authorized with respect to the transferor of the property in a transaction upon which the basis of the property depends, when the determination is with respect to the original transferee or a subsequent transferee of such original transferee.

(c) The application of this section may be illustrated by the following examples:

Example 1. In 1949 taxpayer A transferred property which had cost him \$5,000 to the X Corporation in exchange for an original issue of shares of its stock having a fair market value of \$10,000. In his return for 1949 taxpayer A treated the exchange as one in which the gain or loss was not recognizable:

(i) In 1955 the X Corporation maintains that the gain should have been recognized in the exchange in 1949 and therefore the property it received had a \$10,000 basis for depreciation. Its position is adopted in a closing agreement. No adjustment is authorized with respect to the tax of the X Corporation for 1949, as none of the three types of errors specified in paragraph (a) of this section occurred with respect to the X Corporation in the treatment of the exchange in 1949. Moreover, no adjustment is authorized with respect to taxpayer A, as he is not within any of the three classes of taxpayers described in paragraph (b) of this section.

(ii) In 1953 taxpayer A sells the stock which he received in 1949 and maintains that, as gain should have been recognized in the exchange in 1949, the basis for computing the profit on the sale is \$10,000. His position is confirmed in a closing agreement executed in 1955. An adjustment is authorized with respect to his tax for the year 1949 as the basis for computing the gain on the sale depends upon the transaction in 1949, and in respect of that transaction there was an erroneous nonrecognition of gain to taxpayer A, the taxpayer with respect to whom the determination is made.

Example 2. In 1950 taxpayer A was the owner of 10 shares of the common stock of the Z Corporation which had a basis of \$1,500. In that year he received as a dividend thereon 10 shares of the preferred stock of the same corporation having a fair market value of \$1,000. On his books, entries were made reducing the basis of the common stock by allocating \$500 of the basis to the preferred stock, and on his return for 1950 he did not include the dividend in gross income.

(i) In 1951 taxpayer A made a gift of the preferred stock of the Z Corporation to taxpayer B, an unrelated individual. Taxpayer B sold the stock in 1953 and on his return for that year he reported the sale and claimed a basis of \$1,000, contending that the dividend of preferred stock was taxable to A in 1950 at its fair market value of \$1,000. The basis of \$1,000 is confirmed by a closing agreement executed in 1955. An adjustment is authorized with respect to taxpayer A's tax for 1950, as the closing agreement determines basis of property, and in a prior transaction upon which such basis depends there was an erroneous omission from gross income of taxpayer A, a taxpayer who acquired title to the property in the erroneously treated transaction and from whom, immediately, the taxpayer with respect to whom the determination is made derived title.

(ii) Assuming the same facts as in (i) except that the common stock instead of the preferred stock was the subject of the gift, and the basis claimed by taxpayer B and confirmed in the closing agreement was \$1,500. An adjustment is authorized with respect to taxpayer A's tax for 1950, as the closing agreement determines the basis of property, and in a prior transaction which was erroneously treated as affecting such basis there was an erroneous omission from gross income of taxpayer A, a taxpayer who had title to the property at the time of the erroneously treated transaction, and from whom, immediately, taxpayer B, with respect to whom the determination is made, derived title. The basis of the property in taxpayer B's hands with respect to whom the determination is made is determined under section 1015(a) (relating to the basis of property acquired by gift).

Example 3. In 1950 taxpayer A sold property acquired at a cost of \$5,000 to taxpayer B for \$10,000. In his return for 1950 taxpayer A failed to include the profit on such sale. In 1953 taxpayer B sold the property for \$12,000, and in his return for 1953 reported a gain of \$2,000 upon the sale, which is confirmed by a closing agreement executed in 1955. No adjustment is authorized with respect to the tax of taxpayer A for 1950, as he does not come within any of the three classes of taxpayers described in paragraph (b) of this section.

Example 4. In 1950 a taxpayer who owned 100 shares of stock in Corporation Y received \$1,000 from the corporation which amount the taxpayer reported on his return for 1950 as a taxable dividend. In 1952 Corporation Y was completely liquidated and the taxpayer received in that year liquidating distributions totalling \$8,000. In his return for 1952 the taxpayer reported the receipt of the \$8,000 and computed his gain or loss upon the liquidation by using as a basis the amount which he paid for the stock. The Commissioner maintained that the distribution in 1950 was a distribution out of capital and that in computing the taxpayer's gain or loss upon the liquidation in 1952, the basis of the stock should be reduced by the \$1,000. This position is adopted in a closing agreement executed in 1955 with respect to the year 1952. An adjustment is authorized with respect to the year 1950 as the basis for computing gain or loss in 1952 depends upon the transaction in 1950, and in respect of the 1950 transaction (upon which the basis of the property depends) there was an erroneous inclusion in gross income of the taxpayer with respect to whom the determination is made.

Example 5. In 1946 a taxpayer received 100 shares of stock of the X Corporation having a fair market value of \$5,000, in exchange for shares of stock in the Y Corporation which

he had acquired at a cost of \$12,000. In his return for 1946 the taxpayer treated the exchange as one in which gain or loss was not recognizable. The taxpayer sold 50 shares of the X Corporation stock in 1947 and in his return for that year treated such shares as having a \$6,000 basis. In 1952, the taxpayer sold the remaining 50 shares of stock of the X Corporation for \$7,500 and reported \$1,500 gain in his return for 1952. After the expiration of the period of limitations on deficiency assessments and on refund claims for 1946 and 1947, the Commissioner asserted a deficiency for 1952 on the ground that the loss realized on the exchange in 1946 was erroneously treated as nonrecognizable, and the basis for computing gain upon the sale in 1952 was \$2,500, resulting in a gain of \$5,000. The deficiency is sustained by the Tax Court in 1955. An adjustment is authorized with respect to the year 1946 as to the entire \$7,000 loss realized on the exchange, as the Court's decision determines the basis of property, and in a prior transaction upon which such basis depends there was an erroneous nonrecognition of loss to the taxpayer with respect to whom the determination was made. No adjustment is authorized with respect to the year 1947 as the basis for computing gain upon the sale of the 50 shares in 1952 does not depend upon the transaction in 1947 but upon the transaction in 1946.

[T.D. 6500, 25 FR 12035, Nov. 26, 1960, as amended by T.D. 6617, 27 FR 10824, Nov. 7, 1962]

§ 1.1312-8 Law applicable in determination of error.

The question whether there was an erroneous inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition is determined under the provisions of the internal revenue laws applicable with respect to the year as to which the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, was made. The fact that the inclusion, exclusion, omission, allowance, disallowance, recognition, or nonrecognition, as the case may be, was in pursuance of an interpretation, either judicial or administrative, accorded such provisions of the internal revenue laws at the time of such action is not necessarily determinative of this question. For example, if a later judicial decision authoritatively alters such interpretation so that such action was contrary to such provisions of the internal revenue laws as later interpreted, the inclusion, exclusion, omission, allowance, disallowance, recogni-

tion, or nonrecognition, as the case may be, is erroneous within the meaning of section 1312.

[T.D. 6500, 25 FR 12036, Nov. 26, 1960. Redesignated by T.D. 6617, 27 FR 10824, Nov. 7, 1962]

§ 1.1313(a)-1 Decision by Tax Court or other court as a determination.

(a) A determination may take the form of a decision by the Tax Court of the United States or a judgment, decree, or other order by any court of competent jurisdiction, which has become final.

(b) The date upon which a decision by the Tax Court becomes final is prescribed in section 7481.

(c) The date upon which a judgment of any other court becomes final must be determined upon the basis of the facts in the particular case. Ordinarily, a judgment of a United States district court becomes final upon the expiration of the time allowed for taking an appeal, if no such appeal is duly taken within such time; and a judgment of the United States Court of Claims becomes final upon the expiration of the time allowed for filing a petition for certiorari if no such petition is duly filed within such time.

[T.D. 6500, 25 FR 12036, Nov. 26, 1960]

§ 1.1313(a)-2 Closing agreement as a determination.

A determination may take the form of a closing agreement authorized by section 7121. Such an agreement may relate to the total tax liability of the taxpayer for a particular taxable year or years or to one or more separate items affecting such liability. A closing agreement becomes final for the purpose of this section on the date of its approval by the Commissioner.

[T.D. 6500, 25 FR 12036, Nov. 26, 1960]

§ 1.1313(a)-3 Final disposition of claim for refund as a determination.

(a) *In general.* A determination may take the form of a final disposition of a claim for refund. Such disposition may result in a determination with respect to two classes of items, i.e., items included by the taxpayer in a claim for refund and items applied by the Commissioner to offset the alleged overpayment. The time at which a disposition