

**Internal Revenue Service, Treasury**

**§ 1.1314(a)-2**

that such correction may have on the computation of gross income, taxable income, and other matters under chapter 1 of the Code. If the treatment of any item upon which the tax previously determined was based, or if the application of any provisions of the internal revenue laws with respect to such tax, depends upon the amount of income (e.g. charitable contributions, foreign tax credit, dividends received credit, medical expenses, and percentage depletion), readjustment in these particulars will be necessary as part of the recomputation in conformity with the change in the amount of the income which results from the correct treatment of the item or items in respect of which the error was made.

(d) Any interest or additions to the tax collected as a result of the error shall be taken into account in determining the amount of the adjustment.

(e) The application of this section may be illustrated by the following example:

*Example:* (1) For the taxable year 1949 a taxpayer with no dependents, who kept his books on the cash receipts and disbursements method, filed a joint return with his wife disclosing adjusted gross income of \$42,000 deductions amounting to \$12,000, and a net income of \$30,000. Included among other items in the gross income were salary in the amount of \$15,000 and rents accrued but not yet received in the amount of \$5,000. During the taxable year he donated \$10,000 to the American Red Cross and in his return claimed a deduction of \$6,300 on account thereof, representing the maximum deduction allowable under the 15-percent limitation imposed by section 23(o) of the Internal Revenue Code of 1939 as applicable to the year 1949. In computing his net income he omitted interest income amounting to \$6,000 and neglected to take a deduction for interest paid in the amount of \$4,500. The return disclosed a tax liability of \$7,788, which was assessed and paid. After the expiration of the period of limitations upon the assessment of a deficiency or the allowance of a refund for 1949, the Commissioner included the item of rental income amounting to \$5,000 in the taxpayer's gross income for the year 1950 and asserted a deficiency for that year. As a result of a final decision of the Tax Court of the United States in 1955 sustaining the deficiency for 1950, an adjustment is authorized for the year 1949.

(2) The amount of the adjustment is computed as follows:

Tax previously determined for 1949 .....	\$7,788
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Net income for 1949 upon which tax previously determined was based .....	30,000
Less: Rents erroneously included .....	5,000
Balance .....	25,000
Adjustment for contributions (add 15 percent of \$5,000) .....	750
Net income as adjusted .....	25,750
Tax as recomputed .....	6,152
Tax previously determined .....	7,788
Difference .....	1,636
Amount of adjustment to be refunded or credited	1,636

(3) In accordance with the provisions of paragraph (c) of this section, the recomputation to determine the amount of the adjustment does not take into consideration the item of \$6,000 representing interest received, which was omitted from gross income, or the item of \$4,500 representing interest paid, for which no deduction was allowed.

[T.D. 6500, 25 FR 12038, Nov. 26, 1960]

**§ 1.1314(a)-2 Adjustment to other barred taxable years.**

(a) An adjustment is authorized under section 1311 with respect to a taxable year or years other than the year of the error, but only if all of the following requirements are met:

(1) The tax liability for such other year or years must be affected, or must have been treated as affected, by a net operating loss deduction (as defined in section 172) or by a capital loss carryback or carryover (as defined in section 1212).

(2) The net operating loss deduction or capital loss carryback or carryover must be determined with reference to the taxable year with respect to which the error was made.

(3) On the date of the determination the adjustment with respect to such other year or years must be prevented by some law or rule of law, other than sections 1311 through 1315 and section 7122 and the corresponding provisions of prior revenue laws.

(b) The amount of the adjustment for such other year or years shall be computed in a manner similar to that provided in § 1.1314(a)-1. The tax previously determined for such other year or years shall be ascertained. A recomputation must then be made to ascertain the increase or decrease in tax, if any, resulting solely from the correction of the net operating loss deduction or capital loss carryback or carryover.

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The difference between the tax previously determined and the tax as recomputed is the amount of the adjustment. In the recomputation, no consideration shall be given to items other than the following:

(1) The items upon which the tax previously determined for such other year or years was based, and

(2) The net operating loss deduction or capital loss carryback or carryover as corrected.

In determining the correct net operating loss deduction or capital loss carryback or carryover, no changes shall be made in taxable income (net income in the case of taxable years subject to the provisions of the Internal Revenue Code of 1939 or prior revenue laws), net operating loss or capital loss, for any barred taxable year, except as provided in section 1314. Section 172 and the corresponding provisions of prior revenue laws, and the regulations promulgated thereunder, prescribe the methods of computing the net operating loss deduction. Section 1212 and the corresponding provisions of prior revenue laws, and the regulations promulgated thereunder, prescribe the methods for computing the capital loss carryback and carryover.

(c) A net operating loss deduction or a capital loss carryback or carryover determined with reference to the year of the error may affect, or may have been treated as affecting, a taxable year with respect to which an adjustment is not prevented by the operation of any law or rule of law. In such case, the appropriate adjustment shall be made with respect to such open taxable year. However, the redetermination of the tax for such open taxable year is not made pursuant to part II (section 1311 and following), subchapter Q, chapter 1 of the Code, and the adjustment for such open year and the method of computation are not limited by the provisions of said sections.

(d) The application of this section may be illustrated by the following example:

*Example:* The taxpayer is a corporation which makes its income tax returns on a calendar year basis. Its net income in 1949, computed without any net operating loss deduction was \$10,000, but because of a net oper-

ating loss deduction in excess of that amount resulting from a carryback of a net operating loss claimed for 1950, it paid no income tax for 1949. On its return for 1950 it showed an excess of deductions over gross income of \$14,000, and it paid no income tax for 1950. For the year 1951 its net income, computed without any net operating loss deduction, was \$15,000, and a net operating loss deduction of \$13,000 was allowed (\$4,000 of which was attributable to the carryover from 1950 and \$9,000 of which was attributable to the carryback of a net operating loss of \$9,000 sustained in 1952). In 1957 the assessment of deficiencies or the allowance of refunds for all of said years are barred by the statute of limitations.

(i) A Tax Court decision entered in 1957 with respect to the taxable year 1953 constituted a determination under which an adjustment is authorized to the taxable year 1950, the year with respect to which the error was made. This adjustment increases income for said year by \$15,000, so that instead of a net operating loss of \$14,000, its corrected net income is \$1,000 for 1950, and the tax computed on that income will be assessed as a deficiency for 1950. An adjustment is authorized under this section with respect to each of the years 1949 and 1951, as the tax liability for each year was treated as affected by a net operating loss deduction which was determined by a computation in which reference was made to the year 1950. In the recomputation of the tax for 1949, the net operating loss carryback from 1950 will be eliminated, and in the recomputation of the tax for 1951 the net operating loss carryover from 1950 will be eliminated; for each of the years 1949 and 1951 there will be an adjustment which will be treated as a deficiency for said year.

(ii) Assuming the same facts, except that the correction with respect to the year 1950 increases the net operating loss for said year from \$14,000 to \$20,000. As a result of this correction, there will be no change in the tax due for 1949 and 1950. However, the net operating loss deduction for 1951 is recomputed to be \$19,000, the aggregate of the \$10,000 carryover from 1950 and the \$9,000 carryback from 1952 (the carryover from 1950 is the excess of the \$20,000 net operating loss for 1950 over the \$10,000 net income for 1949, such 1949 income being determined without any net operating loss deduction). As a result of the correction of the net operating loss deduction for 1951, the tax recomputation will show no tax due for said year, and the adjustment for 1951 will result in a refund or credit of the tax previously paid. Moreover, computations resulting from this adjustment will disclose a net operating loss carryover from 1952 to 1953 of \$4,000, that is, the excess of the \$9,000 net operating loss for 1952 over the \$5,000 net income for 1951 (such net income for 1951 being computed as the \$15,000 reduced by the carryover of \$10,000 from 1950,

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the carryback from 1952 not being taken into account). A further adjustment is authorized under section 1311 with respect to any subsequent barred year in which the tax liability is affected by a carryover of the net operating loss from 1952, inasmuch as such carryover from 1952 has been determined by a computation in which reference was made to 1950, the taxable year of the error.

[T.D. 6500, 25 FR 12038, Nov. 26, 1960, as amended by T.D. 7301, 39 FR 972, Jan. 4, 1974]

### § 1.1314(b)-1 Method of adjustment.

(a) If the amount of the adjustment ascertained pursuant to § 1.1314(a)-1 or § 1.1314(a)-2 represents an increase in tax, it is to be treated as if it were a deficiency determined by the Commissioner with respect to the taxpayer as to whom the error was made and for the taxable year or years with respect to which such adjustment was made. The amount of such adjustment is thus to be assessed and collected under the law and regulations applicable to the assessment and collection of deficiencies, subject, however, to the limitations imposed by § 1.1314(c)-1. Notice of deficiency, unless waived, must be issued with respect to such amount or amounts, and the taxpayer may contest the deficiency before the Tax Court of the United States or, if he chooses, may pay the deficiency and later file claim for refund. If the amount of the adjustment ascertained pursuant to § 1.1314(a)-1 or § 1.1314(a)-2 represents a decrease in tax, it is to be treated as if it were an overpayment claimed by the taxpayer with respect to whom the error was made for the taxable year or years with respect to which such adjustment was made. Such amount may be recovered under the law and regulations applicable to overpayments of tax, subject, however, to the limitations imposed by § 1.1314(c)-1. The taxpayer must file a claim for refund thereof, unless the overpayment is refunded without such claim, and if the claim is denied or not acted upon by the Commissioner within the prescribed time, the taxpayer may then file suit for refund.

(b) For the purpose of the adjustments authorized by section 1311, the period of limitations upon the making of an assessment or upon refund or credit, as the case may be, for the taxable year of an adjustment shall be

considered as if, on the date of the determination, one year remained before the expiration of such period. The Commissioner thus has one year from the date of the determination within which to mail a notice of deficiency in respect of the amount of the adjustment where such adjustment is treated as if it were a deficiency. The issuance of such notice of deficiency, in accordance with the law and regulations applicable to the assessment of deficiencies will suspend the running of the 1-year period of limitations provided in section 1314(b). In accordance with the applicable law and regulations governing the collection of deficiencies, the period of limitation for collection of the amount of the adjustment will commence to run from the date of assessment of such amount. (See section 6502 and corresponding provisions of prior revenue laws.) Similarly, the taxpayer has a period of one year from the date of the determination within which to file a claim for refund in respect of the amount of the adjustment where such adjustment is treated as if it were an overpayment. Where the amount of the adjustment is treated as if it were a deficiency and the taxpayer chooses to pay such deficiency and contest it by way of a claim for refund, the period of limitation upon filing a claim for refund will commence to run from the date of such payment. See section 6511 and corresponding provisions of prior revenue laws.

(c) The amount of an adjustment treated as if it were a deficiency or an overpayment, as the case may be, will bear interest and be subject to additions to the tax to the extent provided by the internal revenue laws applicable to deficiencies and overpayments for the taxable year with respect to which the adjustment is made. In the case of an adjustment resulting from an increase or decrease in a net operating loss or net capital loss which is carried back to the year of adjustment, interest shall not be collected or paid for any period prior to the close of the taxable year in which the net operating loss or net capital loss arises.

(d) If, as a result of a determination provided for in § 1.1313(a)-4, an adjustment has been made by the assessment