

1964

# Disallowances of Losses and Deductions and Characterization of Gains between Related Persons

Jerry M. Hamovit

Follow this and additional works at: <https://scholarlycommons.law.case.edu/caselrev>



Part of the [Law Commons](#)

---

## Recommended Citation

Jerry M. Hamovit, *Disallowances of Losses and Deductions and Characterization of Gains between Related Persons*, 15 W. Res. L. Rev. 270 (1964)

Available at: <https://scholarlycommons.law.case.edu/caselrev/vol15/iss2/8>

This Symposium is brought to you for free and open access by the Student Journals at Case Western Reserve University School of Law Scholarly Commons. It has been accepted for inclusion in Case Western Reserve Law Review by an authorized administrator of Case Western Reserve University School of Law Scholarly Commons.

foreign taxes. The Commissioner cautions that appropriate steps should be taken to protect the foreign taxpayer's interests.<sup>107</sup>

### CONCLUSION

Section 482 has been in effect for more than forty years and has been applied extensively by the Commissioner. When one considers the breadth of section 482 and the discretionary nature of its application, it is somewhat surprising to find that the Commissioner's determination has been upset as often as it has been. Nonetheless, section 482 continues to be a very potent weapon in the Commissioner's hands, and indications are that increased reliance upon this section may be expected in the years to come, particularly when section 482 is invoked in conjunction with related provisions of the Code and the broad nonstatutory principles of taxation developed by the courts over the years.

## IV

### DISALLOWANCES OF LOSSES AND DEDUCTIONS AND CHARACTERIZATION OF GAINS BETWEEN RELATED PERSONS

Jerry M. Hamovit

In dealings between family members and related persons, their near-identity of economic interests and the fact that arms-length bargaining between them generally can be subordinated to the desire for tax avoidance led the Congress to enact special rules applicable to dealings of this group.<sup>1</sup> These rules recharacterize for tax purposes what otherwise would be capital gains on the one hand or deductible losses, expenses, and interest on the other. The two principal sections of the Internal Revenue Code effecting this recharacterization are section 267, which applies to deductible losses, expenses, and interest, and section 1239 which, in the rare cases where it is applicable, converts what would otherwise be capital gain into ordinary income.

Section 267 consists of three operative parts. *First*, subsection (a)

---

107. T.I.R. 491, CCH 1963 STAND. FED. TAX REP. ¶ 6517 (July 17, 1963). Tax conventions between the United States and certain foreign countries typically give the taxing authority of the particular country the power to allocate profits between related domestic and foreign enterprises. See, e.g., *Tax Convention Between The United States And Canada*, T.D. 5206, 1943-1 CUM. BULL. 526.

provides for the disallowance of deductions, both loss deductions and those for unpaid expenses and interest, which, but for this provision, otherwise would be deductible. *Second*, subsections (b) and (c) outline the group to whom these disallowance provisions are applicable through a detailed definition of related persons contained in subsection (b) and provisions for calculating the constructive ownership of stock contained in subsection (c). *Third*, subsection (d) provides a limited mitigation of the loss disallowance invoked by subsection (a).

#### RELATED PERSONS UNDER SECTION 267

This section applies to transactions between a statutorily-defined group. It establishes its own broad attribution rules, differing from those contained in section 318 applicable to stock redemptions, sections 1311-15 dealing with the mitigation of limitations, and the other attribution sections of the Code. Neither a lack of affection between these defined related persons nor the existence of good-faith bargaining on the prices or terms arrived at is efficacious in avoiding disallowance from this statute where its terms apply. Likewise, where a transaction is not between the category of related persons defined in section 267, that statute has no applicability. In enacting legislation to cope with the problem of tax avoidance between related persons, Congress drafted relatively automatic rules and avoided the necessity for determining whether there was an actual economic loss or whether one of the motivating factors for the transaction was tax avoidance.

#### *Members of a Family*

The first category of related persons to which this statute applies is "members of a family group." This category includes brothers, sisters, a spouse, ancestors, or lineal descendants. Transactions with in-laws are outside the ambit of this statute.<sup>2</sup> A taxpayer's transfer to his son-in-law and daughter as tenants in common is treated as a transfer to a related person only to the extent of the daughter's fractional share — one half.<sup>3</sup>

The transferor's filing of a joint return with a person related to the transferee does not invoke disallowance. Thus, in *J. Henry DeBoer*,<sup>4</sup> the taxpayer sustained a loss in a bona fide transaction with his wife's

1. Revenue Act of 1934, ch. 277, 48 Stat. 680, 691, adding § 24(a)(6); Revenue Act of 1937, ch. 815, 50 Stat. 813, adding § 24(c); Revenue Act of 1951, ch. 521, 65 Stat. 452, adding § 117(o).

2. Fernel Topek, 9 T.C. 763 (1947); Maurice Bower Saul, 6 CCH Tax Ct. Mem. 734 (1947).

3. Walter Simister, Jr., 4 T.C. 470 (1944).

4. 16 T.C. 662 (1951), *non-acq.*, 1951-2 CUM. BULL. 5, *aff'd per curiam*, 194 F.2d 289 (2d Cir. 1952).

grandson by a former marriage. He claimed the loss as a deduction on his joint return filed with his wife, the transferee's grandmother. Had his wife sustained the loss, it clearly would have been non-deductible. But the courts sustained the taxpayer even though this deductible loss might have resulted in eliminating tax on the wife's income in view of the joint return filed.

Realities control as to whether the transfer actually has been between related persons. Thus, a loss may be disallowed under section 267 where an in-law serves as a nominee for a related person of the transferor, or where a straw man has been set up as a conduit for later transfer to a proscribed person.<sup>5</sup> Conversely, where the actual purchaser is a son-in-law, not a related person for purposes of section 267, the fact that he chooses to take title jointly with the transferor's daughter as tenants by the entirety does not result in any part of the loss being disallowed.<sup>6</sup>

### *Parties to a Trust*

With its definition of related persons, the statute embraces various categories of parties to a trust, including (1) the grantor and fiduciary of the same trust;<sup>7</sup> (2) fiduciaries of different trusts with a common grantor;<sup>8</sup> (3) a fiduciary and a beneficiary of the same trust<sup>9</sup> or of different trusts with a common grantor;<sup>10</sup> and (4) the fiduciary of a trust and a corporation controlled by either that trust or its grantor.<sup>11</sup> As clarified by a Revenue Ruling, a corporation which establishes a pension plan, along with its subsidiaries who are parties to the plan, is a grantor of the trust forming a part of the plan, so that losses on transfers by that corporation to the pension trust will be disallowed.<sup>12</sup> Presumably, the Service may similarly consider a participant in a pension plan a beneficiary of the pension trust, and, therefore, a related person under section 267 should he engage in sales of property to the pension trust.

---

5. *Nordling v. Commissioner*, 166 F.2d 703 (9th Cir. 1948); *Robert Boehm*, 28 T.C. 407 (1957), *aff'd per curiam*, 255 F.2d 684 (2d Cir. 1958).

6. *Stern v. Commissioner*, 215 F.2d 701 (3d Cir. 1954).

7. INT. REV. CODE OF 1954, § 267(b)(4) [hereinafter cited as CODE §]. The estate of the grantor is not, however, a related party to the fiduciary. Rev. Rul. 56-222, 1956-1 CUM. BULL. 155.

8. CODE § 267(b)(5).

9. CODE § 267(b)(6).

10. CODE § 267(b)(7).

11. CODE § 267(b)(8).

12. Rev. Rul. 61-163, 1961-2 CUM. BULL. 58.

*The Individual and His Controlled Corporation*

An important category of related persons is that of the individual and his controlled corporation.<sup>13</sup> Transfers between an estate and its controlled corporation are not similarly proscribed by section 267.<sup>14</sup> Control for this purpose requires ownership of *more* than 50% in value of the corporation's stock, either directly or through the constructive ownership rules of section 267. It is not established by exactly 50% ownership.<sup>15</sup> Furthermore, the test is value, not voting power. Ownership of more than 50% of the voting shares, but less than 50% of the value, does not imply control for the purpose of this statute.<sup>16</sup> And the control relationship results in disallowance so long as it exists at any stage of the loss transaction, whether acquired or relinquished as a part of that transaction.<sup>17</sup>

Evaluation of the extent of control requires consideration of the constructive ownership rules of this statute. Stock owned directly or indirectly by a corporation, partnership, estate, or trust is considered owned proportionately by its shareholders, partners, or beneficiaries.<sup>18</sup> An individual also is deemed to own the stock owned directly or indirectly by members of his family.<sup>19</sup> Finally, an individual is deemed to own the stock owned directly or indirectly by his partners.<sup>20</sup>

Reattribution of stock constructively owned is required only for stock owned by a corporation, partnership, estate, or trust.<sup>21</sup> In any event, reattribution does not determine the parties to a transaction, but only the extent of their ownership. Thus, in *Estate of Hanna v. Commissioner*,<sup>22</sup> a loss on a transaction between an estate and its controlled corporation was allowed even though through constructive ownership the beneficiaries of the transferor estate owned 100% of the stock of the transferee corporation. Nevertheless, the Court of Appeals for the Sixth Circuit concluded that the transaction was not between these beneficiaries and their controlled corporation.<sup>23</sup>

13. CODE § 267(b) (2).

14. *Estate of Hanna v. Commissioner*, 320 F.2d 54 (6th Cir. 1963).

15. *Hallbrett Realty Corp.*, 15 T.C. 157 (1950).

16. *Jacob M. Kaplan*, 21 T.C. 134 (1953).

17. *Moore v. Commissioner*, 202 F.2d 45 (5th Cir. 1953); *W. A. Drake, Inc. v. Commissioner*, 145 F.2d 365 (10th Cir. 1944); *Federal Cement Tile Co.*, 40 T.C. No. 114 (Sept. 26, 1963).

18. CODE § 267(c) (1).

19. CODE § 267(c) (2). Collateral relatives are not included as a part of the family for purposes of these attribution rules. *Graves Brothers Co.*, 17 T.C. 1499 (1952).

20. CODE § 267(c) (3); *Fritz Busche*, 23 T.C. 709 (1955), *aff'd per curiam*, 229 F.2d 437 (5th Cir. 1956).

21. CODE § 267(c) (5).

22. 320 F.2d 54 (6th Cir. 1963).

23. Perhaps if the Hanna Estate had directly owned 100% of the stock of the transferee corporation, without recourse to the constructive ownership rules, the loss would have been disallowed as lacking in economic reality. *Higgins v. Smith*, 308 U.S. 473 (1940).

### *Controlled Personal Holding Companies*

Two corporations are treated as related where either is a personal holding company or a foreign personal holding company for its taxable year preceding the sale or exchange and where more than 50% in value of the stock of each is owned, directly or indirectly, by the same individual.<sup>24</sup> With the above exception, section 267 does not result in disallowance of losses in transactions between affiliated corporations. Without reliance on section 267, however, the courts nevertheless have disallowed losses on sales between a parent and its wholly-owned subsidiary, concluding that such losses lack economic reality or are not bona fide.<sup>25</sup>

### *The Individual and His Controlled Exempt Organization*

The final category of related persons for purposes of section 267 is that of the individual and the exempt organization which he or his family directly or indirectly controls.<sup>26</sup>

## DISALLOWANCE OF LOSS DEDUCTIONS

When the proscribed relationship exists between parties to a sale or exchange, section 267(a)(1) denies any deduction for a loss on that sale or exchange, without regard to the bona fides of the sale and no matter how spirited the arms-length bargaining. In considering transactions between such related parties, the Supreme Court enunciated the justification for this Congressional enactment by holding:

It is a fair inference that even legally genuine intra-group transfers were not thought to result, usually, in economically genuine realizations of loss, and accordingly that Congress did not deem them to be appropriate occasions for the allowance of deductions.<sup>27</sup>

### *Losses on Sales or Exchanges*

The disallowance of loss deductions from sales or exchanges required by section 267(a)(1) applies to transactions "directly or indirectly" between related parties. Accordingly, the courts have disallowed losses to unrelated or unknown third parties on stock exchange

24. CODE § 267(b)(3).

25. *Crown Cork Int'l Corp. v. Commissioner*, 149 F.2d 968 (3d Cir. 1945); *Bank of America Nat'l Trust & Sav. Ass'n v. Commissioner*, 193 F.2d 178 (9th Cir. 1951) (per curiam); *National Lead Co.*, 40 T.C. No. 35 (May 14, 1963).

26. CODE § 267(b)(9). Apparently this provision, added in the 1954 Code, overrules the result in *Jacob M. Kaplan*, 21 T.C. 134 (1953).

27. *McWilliams v. Commissioner*, 331 U.S. 694, 699 (1947).

or over-the-counter sales where a related person purchases at substantially the same time.<sup>28</sup>

The requirement for a "sale or exchange" as the occasion for disallowance has been construed liberally. A loss on the transfer of property in payment of a debt is covered by section 267<sup>29</sup> as is a stock redemption.<sup>30</sup> In *Henry V. B. Smith*,<sup>31</sup> the taxpayer withdrew from a joint venture in which his mother and sisters were the remaining venturers and obtained his distributive share in cash. The Tax Court treated the withdrawal as a sale by the taxpayer to the related parties and disallowed the loss. Had the venture been terminated, all its assets sold, and the proceeds distributed, the taxpayer would have been allowed the loss deduction. In the absence of this complete termination, however, section 267 was successfully invoked against the taxpayer.

There is justification, nevertheless, for concluding that an involuntary transfer is not a sale or exchange with respect to which section 267 may be invoked. Losses from tax foreclosure sales have been allowed by the Fourth and Seventh Circuits;<sup>32</sup> but the Tax Court has disallowed the deduction of a loss on a mortgage foreclosure sale to a related party.<sup>33</sup> While a possible distinction can be made between tax sales and mortgage foreclosure sales on the theory that title vests in the sovereign for a brief moment on a tax sale and thus the sale is not to a related party, this distinction lacks substance, particularly since section 267(a)(1) embraces indirect sales to related parties as well as direct sales. Because planning for tax avoidance is unlikely to play a realistic part in such involuntary transfers as tax sales and mortgage foreclosures, the more favorable treatment to taxpayers of the Fourth and Seventh Circuits seems a significant equitable foundation.

Occasionally, a number of items are sold, some of which result in losses and others in gains. Even where a lump-sum price is used for the entire lot, the courts have refused to permit the tax on the gains to be decreased by offsetting the losses. Each transfer is treated as a separate unit, with a calculation for each item as to whether it results in gain or loss.<sup>34</sup> If, however, separate items become welded together in

28. *Ibid.*; John B. Shethar, 28 T.C. 1222 (1957).

29. *Lakeside Irrigation Co. v. Commissioner*, 128 F.2d 418 (5th Cir.), *cert. denied*, 317 U.S. 666 (1942); I.T. 3334, 1939-2 CUM. BULL. 180.

30. Rev. Rul. 57-387, 1957-2 CUM. BULL. 225.

31. 5 T.C. 323 (1945).

32. *McNeill v. Commissioner*, 251 F.2d 863 (4th Cir.), *cert. denied*, 358 U.S. 823 (1958); *McCarry v. Cripe*, 201 F.2d 679 (7th Cir. 1953). See also *National Metropolitan Bank v. United States*, 111 F. Supp. 422 (Ct. Cl. 1953), where a loss from reversion of title to a related party upon death was not such a sale as to result in disallowance of the loss.

33. *Thomas Zacek*, 8 T.C. 1056 (1947).

34. *Commissioner v. Whitney*, 169 F.2d 562 (2d Cir. 1948), *cert. denied*, 335 U.S. 892 (1948); *Jacob M. Kaplan*, 21 T.C. 134 (1953); *Frank C. Engelhart*, 30 T.C. 1013 (1958).

one physical unit, for example, where bricks, lumber, and hardware are made into a house, or machines and buildings into a plant, and are then sold together, their bases may become consolidated. The resulting possibility in such a case is that gains on some components may be decreased by offsetting losses on others.<sup>35</sup>

### *Losses on Distributions in Corporate Liquidation*

Section 267(a)(1) contains an exception for distributions in corporate liquidations, permitting deductibility of losses realized in such transactions without regard to whether they are with related persons. But a sale by a liquidating trustee to a corporate shareholder is not a liquidating distribution, so that a loss from such a transaction between related parties is disallowed.<sup>36</sup> Moreover, a redemption by a controlling shareholder is not a liquidating distribution, since sections 331 and 346 require at least a contraction of the corporation's business for a partial liquidation.<sup>37</sup>

### EFFECT OF LOSS DISALLOWANCE ON GAIN TO TRANSFEREE FROM RESALE

In enacting the 1954 Code, Congress provided partial mitigation from the disallowance of loss deductions by limiting gain recognized to the transferee from a related taxpayer where the transferee subsequently sells the property. Only so much of the gain as exceeds the amount of loss previously disallowed is subjected to tax.<sup>38</sup> But if the property in question is not sold at a gain by this transferee, or if his gain is less than the amount of the previously disallowed loss, part of that disallowed loss will be forever without tax effect. Moreover, this limitation on gain applies only to the original transferee. If the original transferee has given the property to another before a resale that results in gain, or if it has passed through his estate, this partial mitigation of the loss disallowance is unavailing.<sup>39</sup> Finally, this relief provision has no effect on the transferee's basis for depreciation purposes or otherwise and also has no effect on his holding period.<sup>40</sup>

### ACCRUED BUT UNPAID EXPENSES AND INTEREST

Another major effect of section 267 is to disallow to an accrual basis taxpayer what would otherwise be deductible expenses and inter-

35. *Lakeside Irrigation Co. v. Commissioner*, 128 F.2d 418 (5th Cir.), *cert. denied*, 317 U.S. 666 (1942).

36. *Mathews v. Squire*, 59 F. Supp. 827 (W.D. Wash. 1945).

37. Rev. Rul. 57-387, 1957-2 CUM. BULL. 225.

38. CODE § 267(d).

39. Treas. Reg. § 1.267(d)-1(a)(3) (1958) [hereinafter cited as Reg. §].

40. Reg. § 1.267(d)-1(c) (1958).



est when: (1) within the taxpayer's taxable year plus the next 2½ months, the expenses or interest in question are not paid; (2) within that period, the amount is not includible in the payee's taxable gross income unless paid; and (3) within that period, both the taxpayer and the payee are related persons.<sup>41</sup> When these conditions co-exist, the deduction is lost forever; it cannot be taken in a later year by an accrual basis taxpayer when the disallowed accrued expense is finally paid.<sup>42</sup> The purpose of this provision is to deny a taxpayer the benefit of a deduction through his use of the accrual method of accounting where his related taxpayer may never, or at least within a reasonable period, enter this amount into his taxable income.

### *Accrual Basis Payors and Cash Basis Payees*

On the payor's side, this subsection has practical effect only if the payor is on the accrual basis, since the payee would have no claim to a deduction in the absence of payment in any event were he on the cash basis. Similarly, to meet the second of these three conditions, the payee must be on the cash basis, for an accrual basis taxpayer generally would be required to include the amount in his gross income without regard to the time of payment.

The statutory test of subsection 267 is whether this amount is *includible* in the payee's income, not whether it actually is included. Even if the cash basis payee has included accrued but unpaid amounts in his reported taxable income, the payor's right to a deduction for these amounts is in no way benefited.<sup>43</sup>

### *Payment Within 2½ Months*

As the first of the above conditions makes clear, payment within 2½ months following the close of the payor's taxable year will avoid disallowance from this provision. This time period is strictly construed; it is 2½ months, not 75 days. Thus, in *Mansuss Realty Co. v. Commissioner*,<sup>44</sup> payment within 75 days for a calendar year taxpayer was not timely, since payment on March 15th terminated the 2½ month period. Payment on March 16th, the 75th day, was too late. A resolution directing payment within 90 days following the end of the taxable year was not sufficient to justify a claim of timely constructive payment.<sup>45</sup> Delay

41. CODE § 267(a)(2).

42. *Aptitude Associates, Inc.*, 21 CCH Tax Ct. Mem. 1485 (1962), *aff'd per curiam*, 324 F.2d 499 (4th Cir. 1963). See also Reg. § 1.267(a)-1(b)(2) (1958).

43. *Century Transit Co. v. United States*, 124 F. Supp. 148 (D.C.N.J. 1954); *Hoyt B. Wooten*, 12 T.C. 659 (1949), *aff'd per curiam*, 181 F.2d 502 (6th Cir. 1950).

44. 143 F.2d 286 (2d Cir. 1944).

45. *Young Door Co.*, 40 T.C. No. 96 (Aug. 30, 1963).

in the time of payment beyond 2½ months was not condoned in *Bennett v. United States*,<sup>46</sup> even where the taxpayer had difficulty during that period in computing the amount of profits and, hence, the amount of a bonus he had accrued and sought to deduct.

Payment sufficient to avoid disallowance need not be in cash. Thus, deductions were upheld where payment was by an uncashed check which was covered by funds on deposit or which *could* have been paid.<sup>47</sup> On the other hand, where there was no showing that an uncashed check would have cleared, the Tax Court held payment was not effected and, therefore, disallowed the deductions claimed.<sup>48</sup> Payments avoiding disallowance have been made by demand,<sup>49</sup> term,<sup>50</sup> and non-interest bearing notes.<sup>51</sup> Although the Service has not gone further than to acknowledge that payment by a negotiable promissory note which had a value equal to its face amount constituted payment within the context of this statute, it would seem that payment to the extent of a note's value has been made even where that value is less than the face amount of the note.

Finally, constructive receipt constitutes payment.<sup>53</sup> Thus, a credit on the taxpayer's books was considered payment where the taxpayer was able to borrow sufficient funds to satisfy his obligation to the payee.<sup>54</sup> But where the credit could not be withdrawn by the payee, it was held that neither constructive receipt by the payee nor payment by the taxpayer had occurred and, therefore, the deduction was disallowed.<sup>55</sup>

#### SECTION 1239 AND GAIN ON SALES

Comparable to section 267's disallowance of deductions between related taxpayers is section 1239's conversion of the gain on sales or exchanges between related taxpayers into ordinary income. The Service has ruled that this conversion of capital gain into income applies as well to transfers under section 351 to a controlled corporation, where the transferor receives property other than stock or is benefited by the assumption of liabilities in excess of the basis of the property transferred.<sup>56</sup>

46. 293 F.2d 323 (9th Cir. 1961).

47. J. D. O'Connor, 13 CCH Tax Ct. Mem. 623 (1954); J. R. Holsey Sales Co., 4 CCH Tax Ct. Mem. 500 (1945).

48. H & H Drilling Co., 15 T.C. 961 (1950).

49. Musselman Hub-Brake Co. v. Commissioner, 139 F.2d 65 (6th Cir. 1943).

50. Commissioner v. Mundet Cork Corp., 7 CCH Tax Ct. Mem. 411 (1948), *aff'd per curiam*, 173 F.2d 757 (2d Cir. 1949).

51. Akron Welding and Spring Co., 10 T.C. 715 (1948).

52. Rev. Rul. 55-608, 1955-2 CUM. BULL. 546.

53. CODE § 267(a)(2)(A)(ii).

54. Geiger & Peters, Inc., 27 T.C. 911 (1957); Platt Trailer Co., 23 T.C. 1065 (1955).

55. Francis Metal Door & Window Corp., 17 P-H Tax Ct. Mem. 669 (1948), *aff'd per curiam*, 178 F.2d 405 (2d Cir. 1949).

56. Rev. Rul. 60-302, 1960-2 CUM. BULL. 223.

### *Application to Depreciable Property*

Section 1239 applies only to sales or exchanges of depreciable property. Patents, as depreciable assets, have come within its ambit.<sup>57</sup> But the Tax Court seems to have construed this provision to include as well property which is subject to exhaustion *like* depreciation. The Regulations provide for the deduction of leasehold amortization under section 162,<sup>58</sup> dealing with ordinary and necessary business expenses, and not under section 167 on depreciation. The Tax Court nevertheless concluded that leaseholds, subject to amortization rather than depreciation, are depreciable property subject to section 1239.<sup>59</sup>

When land and the buildings are sold, only the buildings are depreciable property. Accordingly, the portion of gain applicable to the land is not subject to section 1239 and remains taxable as capital gain.<sup>60</sup>

### *Sales Between Spouses or to Controlled Corporations*

The test of a related party under section 1239 is far narrower than that under section 267. Thus, this statute applies only to sales between a husband and wife or between an individual and a corporation more than 80% in value of the outstanding stock of which is owned by that individual, his spouse, and his minor children and grandchildren. While the Treasury Regulations state that beneficial ownership is included in measuring stock ownership for this 80% test,<sup>61</sup> the Court of Appeals for the Fourth Circuit has concluded that stock held in an irrevocable trust for the benefit of minor children is not deemed to be owned by these children.<sup>62</sup>

## RELATED PARTNERSHIP PROVISIONS

Both sections 267 and 1239 have their counterparts in the partnership provisions of the Code. Section 707(b)(1) disallows the loss on a sale between a partnership and its controlling partner or between two partnerships controlled by the same person. In the event a loss is thereby disallowed, gain on a subsequent sale by the transferee is adjusted in a similar manner to the adjustments required by section 267(d).

Likewise, section 707(b)(2) provides that if an 80% controlling partner transfers property to a partnership, which in the partnership's

57. *Kershaw v. United States*, 180 F. Supp. 415 (Ct. Cl. 1960); *Royce Kershaw*, 34 T.C. 453 (1960).

58. Reg. § 1.162-11(a) (1958), as amended, T.D. 6520, 1961-1 CUM. BULL. 52.

59. *Tom F. Baker III*, 38 T.C. 9 (1962).

60. See *W. H. Weaver*, 32 T.C. 411 (1959).

61. Reg. § 1.1239-1 (1957).

62. *Mitchell v. Commissioner*, 300 F.2d 533 (4th Cir. 1962).

hands is not a capital asset, such as inventory or depreciable or real property used in the trade or business, then any capital gain that might normally ensue is converted into ordinary income. The attribution rules of section 267, other than the rule attributing stock ownership as between partners, are applied in evaluating the ownership tests under section 707(b).