1963

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Recommended Citation

Edward J. Hawkins Jr., Mechanics of Carrying Losses to Other Years, 14 Cas. W. Res. L. Rev. 241 (1963)
Available at: http://scholarlycommons.law.case.edu/caselrev/vol14/iss2/14

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However, there are specific statutory enumerations of taxpayers which cannot use a net operating loss or upon which restrictions are imposed in regard to the use of a net operating loss. Restrictions upon or denial of a net operating loss are imposed by statute upon personal holding companies for purposes of computing personal holding company tax, foreign personal holding companies for purposes of computing undistributed foreign personal holding company income, regulated investment companies, partnerships, common trust funds, life and mutual (other than marine) insurance companies, and corporations for purposes of computing the penalty tax on improper accumulation of earnings.

II

MECHANICS OF CARRYING LOSSES TO OTHER YEARS

Edward J. Hawkins, Jr.

The preceding article discussed the problems of determining whether the taxpayer has a net operating loss and, if so, how much. The next and happier step is to carry the loss to a year in which the taxpayer has realized some taxable income. The function of this article is to discuss the mechanics of the carrying process.

The general procedure for carrying net operating losses is quite simple and will be discussed first. We will then turn to certain more difficult questions which can arise as to loss carryovers in particular situations, to wit: (1) the statute of limitations; (2) the possibility of electing not to carry losses chronologically; (3) the effect of a change in the law between the loss year and the profit year; (4) the possibility of de-
storing a carryover with a long term capital gain; (5) the effect of a carryback in one entity on the tax liability of related entities; and (6) the special cases covered by express statutes.

In addition to these problems, the footnotes cover certain rules relating to Subchapter S corporations, to individuals who file joint returns in some years and separate returns in other years, and to taxpayers whose fiscal years overlap changes in the statute.¹

**General Explanation**

The basic rule is that a net operating loss can be carried back three years and forward five years,² being "used up" against the income of these years taken in chronological order.³ Thus, a loss incurred in 1959 is carried first to the third preceding year, 1956. If the 1956 income was not sufficient to completely use up the loss, the balance is then carried to the second preceding year, 1957. The remainder, not used up in that year, is then carried to 1958, and the then balance, if any, is carried to 1960, the first year following the loss, and so forth.

The chronological rule applies in carrying losses to a year as well as from a year. If 1960 is assumed to be a profitable year, the total amount which can be deducted from its profits on account of net operating losses carried over from all eight years (the five preceding years plus the three following years) is known as the net operating loss deduction for 1960. However, in determining which losses were actually used up in eliminating the 1960 profits, one begins with the losses from the earliest of the eight years, in this case 1955. If no operating loss was incurred in 1955, or if it was incurred but was used up against the income of the years before 1960 to which it could be carried, or if the balance not used up was insufficient to wipe out all the 1960 profits, one proceeds to the losses, if any, from the next year, 1956, and then to the losses of 1957, and so forth.

A complication in the carryover procedure lies in determining how much of the loss from 1959 was "used up" in 1956, in order to know how much of the loss remains to be carried to 1957. The "used up" portion is not simply the 1956 taxable income, but the 1956 taxable income subject to a series of modifications.⁴ These modifications include

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1. See note 39 (overlapping years), note 50 (Subchapter S), and note 56 (joint and separate returns), infra.
3. INT. REV. CODE OF 1954, § 172(b) [hereinafter cited as CODE §].
4. CODE § 172(b)(2). It should be noted that the modifications affecting taxable income or adjusted gross income also affect the deductions which are subject to limitations measured by a percentage of income. The effect differs, furthermore, as between the different deduc-

some, but not all, of the modifications made in computing a net operating loss in the first place. In particular, the net operating loss deduction is allowed but only to the extent of losses carried to the year in question, 1956, from years preceding the loss year in question, 1959.\footnote{5} Also, non-corporate taxpayers may not deduct any excess of capital losses over capital gains, nor the deduction for one-half of the excess of net long term capital gains over net short term capital losses.\footnote{6} No deduction for personal exemptions is allowed.\footnote{7} Corporations are not permitted the deduction for partially tax exempt interest, nor the Western Hemisphere trade corporation deduction.\footnote{8} In no case may the taxable income so modified be considered to be less than zero.\footnote{9}

A final basic point is the procedure involved. In preparing almost any timely income tax return, it will be possible to compute the net operating loss deduction only to the extent that this consists of loss carryovers from the five preceding years. If the succeeding three years give rise to losses the carryback of which reduces the tax due for the year in question, it is necessary to obtain a refund. This can be done either by an ordinary claim for refund\footnote{10} or by means of a "tentative carryback adjustment." This adjustment is governed by section 6411, which provides that if the taxpayer applies for the adjustment on the proper form\footnote{11} within twelve months of the end of the loss year, the Commissioner shall normally grant the refund within ninety days. The Commissioner need not allow the application, however, if he finds errors which he is unable or unwilling to correct within the ninety days. (The errors in question are those made in relation to the carryback: disagreement as to the merits of the return originally filed for the profitable year is not a proper ground for disallowing the application).\footnote{12} In any event, proper or improper, the disallowance of the application for a tentative carryback adjustment is not an adequate foundation for a suit for refund. If the application procedure under section 6411 is not successful, the taxpayer must revert to a regular claim for refund.\footnote{13}
One other procedure is available if a corporate taxpayer is confident that it will have a net operating loss in the very next year. In such circumstances, it can apply for an extension of time for filing for the profitable year until the net operating loss can be determined and carried back.\textsuperscript{14}

**Special Problems in Carrying Losses**

**Statute of Limitations**

The general rule is that the statute of limitations is open for carrying back losses to earlier years as long as it is open for filing claims for refund for the year in which the loss was incurred.\textsuperscript{15} The same rule applies in determining the limitations period for assessing deficiencies "attributable to the application to the taxpayer of a net operating loss carryback" (including a tentative carryback adjustment).\textsuperscript{16}

The extent to which the statute is opened up is uncertain. Under the statute governing deficiencies, assessments are limited to items "attributable to the carryback."\textsuperscript{17} The same test governs the Commissioner's review of an application for a tentative carryover adjustment.\textsuperscript{18} Both the Tax Court and the Commissioner agree that under this test, the merits of the return for the year to which the loss is carried are not opened up for re-examination: the only issue is whether the amount of the net operating loss deduction attributable to the carryback in question is correct.\textsuperscript{19}

The Court of Appeals for the Second Circuit holds, however, that if a claim for refund is filed based on a loss carryback, the Commissioner can offset against the claim deficiencies arising from any other item for the

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\textsuperscript{14} The taxpayer should file Form 1138 in this situation, which is governed by \texttt{CODE} § 6164.

\textsuperscript{15} \texttt{CODE} § 6511(d)(2)(A). There are two exceptions to this general rule: (1) Loss carrybacks due to the renegotiations of excessive profits have a longer limitations period. (2) If the return for the loss year was filed late, the refund period for that year runs from the date of filing. The refund period for the carryback, however, is measured by the due date for the return for the loss year.

The common sense inherent in the general rule here stated seems to be a part of the underlying rationale of the recent decision of the Court of Appeals for the Sixth Circuit in Patton v. United States, 305 F.2d 655, rehearing denied, 62-2 U.S. Tax Cas. § 9649 (6th Cir. 1962) (cert. not authorized).


Note that in this case the "general rule" is the specific language of the statute.

\textsuperscript{17} This language is quoted from \texttt{SEN. REP. No.} 1983, supra at 98, and similar language in \texttt{CODE} § 6501(h), is quoted in the text.

\textsuperscript{18} \texttt{CODE} § 6411(b).

year to which the loss is carried, even though the ordinary period of limitations on assessments for that year has expired. It argues that otherwise, a taxpayer carrying back a loss is in a better position than a taxpayer actually incurring the loss in the earlier year. The effect of its rule is to put taxpayers filing one Treasury form in a better position than taxpayers who have chosen a slightly different Treasury form.

It is hard to believe that the inconsistency of result between claims for refund and applications for tentative carryback adjustments will long endure, but at present it is an important factor to consider in choosing which form to file.

Note a further point as to limitations: assume that, because of a carryover, the tax for 1962 depends on the deductions to which taxpayer was entitled in 1955, and that the statute of limitations has run on 1955. It would seem perfectly clear that if the deduction for charitable contributions was handled erroneously for purposes of the tax paid for 1955, the mistake in the barred year should be corrected for the purpose of computing the carryover to 1962, an open year. This means that the deduction in 1962 will be increased or decreased to balance an error made in a barred year. In short, to the extent of a loss carryover, the statute of limitations will in effect be avoided on corrections in the taxable income for the year of the deduction of the loss, and intervening years.

**Are Carryovers Elective?**

Much of this article rests on the assumption that the mechanics of carrying over losses are dictated by law and are not a matter of choice.

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21. Id. at 24. This is probably not true. Under the Van Bergh rule, the Commissioner has a second chance to audit the earlier return, which he would not have had if the loss had been incurred in the earlier year. If the loss had been then incurred, there is no reason to suppose it would have increased the chance the first audit would have uncovered a different unrelated issue; it is more likely in practice that the reduction of reported taxable income would have decreased the revenue agent’s interest.

The Van Bergh opinion also suggests another argument for its result: "He [the Commissioner] argues that, under the doctrine first laid down in Lewis v. Reynolds... the right to a refund depends upon the principles determining an action for money had and received, in which the question always is whether the defendant is entitled in good conscience to keep the money." This is not a good statement of the Lewis v. Reynolds doctrine, and the "good conscience" rule is not much help in tax procedure. It implies that the statute of limitations has no application to defenses against "an action for money had and received," but this would make nonsense out of a number of Code provisions, as well as frequently producing such anomalous results as the Van Bergh case itself.

22. The choice is between Forms 1045 or 1139 on the one hand and Form 843 on the other.
23. E.g., Phoenix Coal Co. v. Commissioner, 231 F.2d 420 (2d Cir. 1956).
This fundamental assumption was rudely challenged by the 1962 district court opinion in Brandon v. United States which concluded that it was not “mandatory upon the taxpayers to carry forward a loss . . . whether electing to do so or not.”

It is believed that the language of the Brandon opinion represents an effort to reach a sound result in a hard case, and that it cannot be taken at face value. For example, assume a taxpayer with a loss in 1956, low bracket income in 1954 and 1955, and high bracket income in 1957. May the taxpayer elect not to carry the loss back to earlier years but to carry it instead direct to the high bracket income in 1957? May he elect to allocate it in portions so as to even out his top tax bracket for each of the three years? What if the taxpayer, after having elected to carry the loss to 1957, discovers that in 1958 he is in a still higher bracket? May he revoke his election, file an amended return for 1957 repaying the tax saved by the loss, and switch the loss to 1958? The statute provides for no such elections, and merely suggesting the possibilities indicates the overwhelming practical objections. Fortunately, the first step in the series, the election to carry the loss to 1957 rather than to 1954 and 1955, has been rejected by the Tax Court in a decision even more recent than the Brandon case.

The Brandon "election" is far different. There, the taxpayer had losses in 1952 and 1954, and profits in 1953. The taxpayer was entitled to carry the 1952 loss forward to 1953 but failed to do so, and the statute ran on such a carryforward. Taxpayer then attempted to carryback the 1954 loss to 1953, but its claim was denied. The theory of the denial was that if the 1953 income were correctly computed, including the deduction for the carryover of the 1952 loss, there was no taxable income, and hence nothing against which the 1954 loss could be applied, even though the taxpayer had clearly paid a tax for 1953. The district court disagreed on the theory that the correct computation for 1953 could not include the 1952 carryover since the taxpayer had not elected to deduct that carryover. As already noted, it is easy to disagree with this theory, but harder to disagree with the court's result.

The real foundation for the court's result is that a refund computation for 1953 does not start with taxable income for 1953, whether correct or incorrect. The first figure in the refund computation is the tax actually paid for 1953, even if paid entirely by mistake. Assume that

25. Id. at 913.
26. Under the law governing losses incurred in 1957, only a two-year carryback was permitted.
27. Prichard Funeral Home, Inc., CCH 1962 TAX CT. REP. (21 CCH Tax Ct. Mem.) Dec. 1399 (Nov. 5, 1962). Note that while tax policy must consider the possibility of taxpayers deliberately switching losses to different years, the taxpayers actually caught by the rule will presumably be those who fell into the pit by mistake.
the claim for refund for 1953 had been based on overlooked real estate taxes. The Commissioner could hardly have denied the claim (after the statute had run on 1953) on the ground that the taxpayer had also overlooked a deduction for interest paid, and hence had zero taxable income even apart from the real estate taxes. The proper rule in such a case is that the taxpayer is entitled to the lesser of (1) the tax actually paid less the tax which would be due if the only adjustment were that stated in the claim for refund and (2) the tax actually paid less the tax which would be due if *all* the adjustments necessary to make the return completely correct were in fact made. In both cases the computation begins with the tax actually paid, without regard to merits of the reasons for the payment.

If the rule just stated is correct, should it make any difference if the deduction overlooked by the taxpayer and discovered by the Commissioner was not for interest paid but for a net operating loss carryover from 1952? No basis can be seen for any such distinction. Should it make a difference, then, if the claim for refund is based on a loss carryback from 1954 rather than on a deduction for real estate taxes? The statute provides that the 1954 loss is part of a 1953 deduction, and it provides no basis relevant here for taking the deductions for any given year in any particular order.

Nevertheless, at this point the government may differ. The 1954 loss could be carried back two years and forward five, and the only way to prevent it from being deducted seven times is the procedure already described by which the loss is deemed to be "used up" by the income of the years to which it is carried, in chronological order. However, for the using up process the usual figure for taxable income is modified, and one of these modifications has the effect of deducting the 1954 loss carryback last. The other deductions are taken first, and if they are sufficient to eliminate taxable income, the 1954 loss is not "used up" and can be

29. Code § 172(a).
30. Perhaps the disagreement might be avoided by a procedural device: including in the claim for refund both the net operating loss carryback and the overlooked deduction for interest paid, even though the latter was barred by the statute of limitations before the claim is filed. Reg. § 301.6511(d)-2(a) (3) (1956), as amended, T.D. 6488, 1960-2 Cum. Bull. 400.
31. Rev. Rul. 218, 1953-2 Cum. Bull. 176, attempts to reach the result contended for by the government in the *Brandon* case by stressing the fact that operating losses are "used up" in chronological order. Note, however, that even if the provisions for "using up" a loss are relevant, they do not distinguish between ordinary deductions (e.g., for interest paid) and deductions for losses carried from years prior to the loss year in question. Thus, the government's case may have turned on the fact the claim was based on a loss carryback, but it added nothing that the deduction overlooked by the taxpayer involved a loss carryover rather than a deduction for interest paid.
32. The sufficiency of the other deductions to eliminate income is based on what deductions should have been taken, not what deductions were taken, so the overlooked interest deduction enters into the computation. See Phoenix Coal Co. v. Commissioner, 231 F.2d 420 (2d Cir. 1956).
carried forward in full to 1955\textsuperscript{33} and deducted again. In this respect a claim for refund based on a net operating loss carryback differs from a claim for refund based on real estate taxes.\textsuperscript{34}

The fact that Mr. Brandon can deduct the loss again in 1955 to the extent of the deduction omitted in 1953 does not mean he is getting a double deduction. The total amount allowed through the carryback to 1953 plus the carryover to 1955 simply equals the amount of the 1954 loss plus the overlooked deduction to which he was entitled in 1953. This is no more than the total deductions to which he was entitled apart from the statute of limitations. Thus the case is simply another illustration of the rule that a claim for loss carryback results, to the extent of the claim, in giving effect to corrections which would otherwise be barred by the statute of limitations.\textsuperscript{35} It has already been noted that if the deduction had been erroneously \textit{included} instead of being erroneously \textit{excluded} in 1953, the loss carryback would have been "used up" against the erroneously untaxed 1953 income,\textsuperscript{36} thus reducing the carryover to 1955 by the amount of the adjustment otherwise barred by the statute.\textsuperscript{36a}

\textsuperscript{33} Under the actual facts in \textit{Brandon}, 1955 was also a loss year, so the effective carryover would have been to 1956.

\textsuperscript{34} A claim for refund based on a net operating loss may also be distinguished from other claims by the availability of the tentative loss carryback procedure. Under this procedure it would seem that the result sought by the government in \textit{Brandon} would have been clearly unavailable. \textit{See note 19 supra and accompanying text.}

\textsuperscript{35} \textit{AESOP, FABLES} (620-560 B.C.) (Same definition of sauce applicable to goose and gander).

\textsuperscript{36} Commissioner v. Van Bergh, 209 F.2d 23 (2d Cir. 1954).

\textsuperscript{36a} Phoenix Coal Co. v. Commissioner, 231 F.2d 420 (2d Cir. 1956); Springfield St. Ry. v. United States, 63-1 U.S. Tax Cas. § 9189 (1963).

If Mr. Brandon now attempts to deduct the 1954 loss a second time, the fact pattern will be exactly the same as that in \textit{Springfield St. Ry.}, except that there the loss year as well as the carryback year was barred and hence the taxpayer lost the advantage of the carryback. This should make no difference. Assume two taxpayers with income of $40 in year 1, and of $100 in year 3, and losses of $100 in year 2. Assume that both taxpayers are in the 50\% bracket, overstate their income by $20 in year 1, and pay a tax of $30 (50\% x $60). The first taxpayer, Mr. Brandon, notices the error after year 1 alone is barred. He carries back the loss from year 2 and recovers the tax of $30. He carries forward a loss of $60 to year 3, leaving taxable income of $40 and a tax of $20. This correctly reflects his net income for the three years as a whole, disregarding the statute of limitations.

The second taxpayer, the Railway, catches the error after both year 1 and year 2 are barred. Thus it gets no adjustment for year 1 but also carries forward a loss of $60 to year 3. Thus it pays a tax of $20 in year 3 for a total tax of the three year period of $50. Had the correction for year 1 not been made in the carryover computation it would have had a loss carryover of only $40 and a tax of $30 in year 3. Thus the correction has resulted in a tax saving exactly equal to the excess tax erroneously paid in year 1. The $30 extra tax which it pays as compared with Mr. Brandon for the three year period as a whole is the tax on a different error, i.e., not carrying back the loss from year 2 to year 1.

By reversing these illustrative cases to assume an understatement of income in year 1 instead of an overstatement, it will be seen that the results follow the same pattern when the shoe is on the Commissioner's foot.
**Choice of Law**

The loss year, the three preceding years, and the five following years, add up to a nine-year period which may be involved in a carryover problem. Since the fateful year 1913, our tax law has never survived any period of anything like this length without undergoing extensive changes. Accordingly, it is necessary to choose which of the tax laws shall prevail of those which obtained at different times during the carryover period.

While the authorities are not complete enough to permit absolute certainty, the "better view" would seem to be summed up by the following rules.

1. The years to which a loss may be carried is determined by the law in effect in the year the loss was incurred.

2. All computations shall be made according to the law governing the year to which the computation primarily relates. By "computation" is meant the calculations relating to any one year, to wit, the calculation of the amount of the loss in the loss year, the calculation of the amount of the loss "used up" in an intervening year, and the calculation of the net operating loss deduction for the profitable year in question, but excluding any part of such calculation which relates primarily to another year.

3. The statute of limitations applicable to the year of the loss determines the period for filing a refund claim based on carryback of the loss.

To illustrate the foregoing rules, assume an individual taxpayer who wants to compute his net operating loss deduction for the year 1953. Assume further that the only net operating loss in the taxpayer's history was incurred in 1954, and that the claim for refund was filed on April 14, 1958. What laws control?

1. The years to which the loss is carried are determined by the 1954 Code governing the year of the loss. Thus, the two-year carryback provided by the 1954 Code controls, and not the one-year carryback provided by the law in effect in 1953. This means that the loss must be

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37. One of the most-monkeyed with rules is the provision as to whether losses can be carried to other years at all, and, if so, to which years. See 5 MERTENS, FEDERAL INCOME TAXATION, § 29.01 (1956).

38. For supporting authorities, see the notes to the ensuing specific illustration of the rules.

39. The illustration assumes a calendar year taxpayer. If the taxpayer uses a fiscal year, and the fiscal year overlaps a change in the law, the situation may be controlled by specific statutory provisions. Fiscal years beginning in 1953 and ending in 1954 are governed in part by CODE § 172(f). Fiscal years beginning in 1957 and ending in 1958 are governed by CODE § 172(i). See also CODE § 172(g)(3). For a further discussion of fiscal years beginning in 1953 and ending in 1954, see Petri, How to Treat the Net Operating Loss, N.Y.U. 14th INST. FED. TAX. 1467, 1477 (1956).

40. In the illustration, this result is required by CODE § 172(g)(2)(A). If the loss year
reduced by the income of 1952, duly adjusted before being carried to 1953.

(2) The computation of the amount of the net operating loss in 1954 is determined under the 1954 Code, since that is the law applicable to the year in which the loss was incurred.41

(3) The 1952 income must be computed to determine how much of the 1954 loss is left to carry to 1953. This computation of 1952 income is made according to 1952 law.42

(4) Is the deduction in 1953 simply the balance of the carryover, as under the 1954 Code, or must it be adjusted still further under the law as it stood in 1953? The answer is that since this computation is of a deduction in 1953, and has no overriding relationship to another year, unlike the preceding two steps, it must be governed by the law in effect in 1953.43

(5) Assuming no extensions of the statute by agreement, the claim for refund based on the 1954 loss and filed on April 14, 1958, was within the statutory period permitted by the 1954 Code, but after the running of the 1939 Code period. The Court of Appeals for the Sixth Circuit has held such a claim to be timely filed, despite a strong statutory argument to the contrary.44

Carryover Destroyed by Capital Gain

If a corporation has a net operating loss deduction greater than its income apart from long term capital gain, the deduction may be "used up" in that year without producing any tax saving whatever.

Assume a long term capital gain of $100,000 and a net operating loss deduction which exceeds the corporation’s ordinary taxable income (computed before such deduction) by $40,000. The corporation will

were 1958, the same result (that the 1958 rule governs) would be required by CODE § 172(b) (1).


As an exception to the rule stated in the text, if the loss year were 1953, the cited Regulation provides that the loss would be computed in some respects as if the 1954 Code rather than the 1939 Code were applicable.

42. CODE §§ 172(e), (g) (2) (B). If the question were one of determining the balance of the 1954 loss to be carried from 1953 to 1955, certain definitional changes between the 1939 and 1954 Codes make the question more difficult, and a result contrary to the general rule stated in the text was reached in Whitney Land Co. v. United States, 62-2 U.S. Tax Cas. § 9616 (D. Minn. 1962). Whitney was in turn criticized in American Bank & Trust Co. v. United States, 63-1 U.S. Tax Cas. § 9253 (E.D. La. 1963).


44. Patton v. United States, 305 F.2d 655 (6th Cir. 1962), rehearing denied, 62-2 U.S. Tax Cas. § 9649 (6th Cir. 1962), (cert. not authorized). The statutory argument is based on CODE § 7851(a) (6) (A).
use the ‘alternative tax’ under which it must pay twenty-five per cent of
its long term capital gain unreduced by the net operating loss deduction. 45
This tax would be $25,000. If the alternative tax were not used, the
capital gain would be taxed as ordinary income, 46 after deduction of the
net operating loss deduction, which would produce a tax of $25,700.

The alternative tax would be no greater and no less than if the corpo-
ration had not had a net operating loss deduction at all. Nevertheless,
in computing the amount of the loss carried to the following year, the
full capital gain is deducted from the loss even though the alternative tax
was used. 47 On the assumed figures, accordingly, the loss would be com-
pletely wiped out in a year in which it did no good.

The same rules apply in determining whether in the year of the capi-
tal gain an excess of ordinary deductions over ordinary income gives rise
to a net operating loss. 48

Effect of Carrybacks on Related Parties

The net operating loss of one entity may affect another entity in sev-
eral ways. In certain circumstances, the loss carryover may be simply
transferred to a successor entity, a process which is discussed in a subse-
quent article. 49 In other cases, the loss is reported originally by an entity
which is not itself a taxpayer, e.g., a partnership, and hence passes through
immediately to another entity, e.g., the partners. The conduit entity, the
partnership, cannot then carry the loss to other years, because the recipi-
ents of the loss, the partners, are already carrying the losses to other
years. 50

Another possibility arises if the entity reporting the loss is itself a
taxpayer, but the income of other taxpayers depends in part upon its ex-

45. CODE § 1201(a); Rev. Rul. 56-247, 1956-1 CUM. BULL. 383; Weil v. Commissioner,
229 F.2d 593 (6th Cir. 1956).
46. If an individual does not use the alternative tax he nevertheless includes only fifty per
cent of the long term capital gain in ordinary income, Code § 1202, but this section does not
apply to corporations. Due to this difference the problem discussed arises more readily for
corporations than for individuals. That it can apply to individuals also is illustrated in Weil
v. Commissioner, 229 F.2d 593 (6th Cir. 1956).
47. CODE § 172(b)(2).
48. CODE § 172(c).
49. See Adelson, Carrying Losses to a Different Taxpayer, at 263 infra. Examples of this are
the transfer of a carryover from a liquidated subsidiary to its parent or from a terminated trust
to its beneficiaries.
50. CODE §§ 701, 702, 703(a) (2) (E).

A similar problem is presented by a corporation which makes the election under Subchap-
ter S. If the corporation has a loss in a year to which the election applies, it cannot carry the
loss to any other year, since it has been passed to its shareholders. CODE § 172(h). Con-
versely, the corporation cannot carry a loss from any other year to a year to which the election
applies. Reg. § 1.172-1(g) (1956), as amended, T.D. 6486, 1960-2 CUM. BULL. 78. Never-
theless, years to which the election applies count as taxable years in determining the carryback
and carryover periods. Ibid.
perience. Thus, beneficiaries of a trust are taxed upon its distributions according to the trust’s “distributable net income,” and shareholders of a corporation are taxed upon its distributions according to its “earnings and profits.”

In the case of the trust (or estate), a loss which it incurs is not directly distributable as such to its beneficiaries, unlike the rule for a partnership which is strictly a conduit. Instead, the loss is retained by the trust and enters into its net operating loss deduction, which is allowed in computing distributable net income. Thus, if the trust has a net operating loss in 1959, the loss is carried back and deducted in 1956. The reduction in “distributable net income” for 1956 will mean that distributions made to beneficiaries in 1956 and treated as income distributions will be converted to principal distributions. Thus, the loss carryback in the trust will give rise to a claim for refund by the beneficiary.

In the case of a corporation, distributions are taxed to its shareholders as dividends to the extent of (1) earnings and profits accumulated before the current year, if any, plus (2) earnings and profits of the current year. In dealing with the category of accumulated earnings, it is clear that a loss is deducted at least once. It is also clear that the same loss cannot be deducted eight more times by means of a net operating loss deduction in the three preceding and the five following years. Is it possible, however, that the year in which the loss is deducted might be determined by the carryback system? In other words, might the 1959 loss be deducted from accumulated earnings and profits as of 1956, the first carryback year, as is done in the case of the distributable net income of a trust? In reference to the second category, earnings and profits of the current year, might the carryback and carryover system be used to determine which years had no earnings and profits?

There is little law on the foregoing questions, but what authority there is indicates a negative answer. The theory seems to be that the net operating loss carryback is simply not applicable to the computation of earnings and profits.

51. CODE §§ 651, 661. A “common trust fund” follows the partnership rule, however. Reg. § 1.584-6 (1956).
52. CODE §§ 301, 316.
54. CODE §§ 316(a) (1), (2).
56. R. M. Weyerhaeuser, 33 B.T.A. 594, 598 (1935). There is another situation in which a “related entity” may complicate the situation. This arises when a taxpayer files a joint return with his spouse in some years and separate returns in other years. Comprehensive rules for such cases are provided by Reg. § 1.172-7 (1956), as amended, T.D. 6486, 1960-2 CUM. BULL. 78.
Special Interest Legislation

It may be gathered from this article that the loss carrying system is rather logical and simple except in certain problem situations. However, in 1962 Congress rose to the challenge and provided special carryover periods for three different classes of taxpayers.

1. "Regulated transportation corporations" now are allowed the usual three year carryback and a seven year, instead of a five year, carryover.\textsuperscript{57}

2. All corporations having net operating losses for the calendar years 1953 or 1954, principally as the result of converting from street railway to bus operations, are to have an eleven year carryover for the 1953 loss and a ten year carryover for the 1954 loss.\textsuperscript{58}

3. Certain companies injured by tariff reductions pursuant to the Trade Expansion Act of 1962 are to have a five year carryback instead of a three year carryback.\textsuperscript{59}

Special tax benefits for particular companies or classes of companies add considerably to the complexity of the Code. Such benefits also weaken any belief that the tax laws apply to all taxpayers in an even-handed manner.\textsuperscript{60} To say that the favored companies cannot fully deduct their losses in the usual carrying period does not justify the benefit. The only companies which would ever want more than the usual carrying period are those which cannot fully deduct their losses in the usual carrying period. On the other hand, the companies listed are all either government regulated or injured by government action \textit{(i.e.,} in the tariff case, injured by reduction in a different special benefit\textit{)}. Also, if subsidies of some kind are in order, extending the loss carrying period may be the least baneful method. Nevertheless, a feeling of disquiet persists.

\begin{footnotesize}
\begin{enumerate}
\item\textsuperscript{57} P.L. 87-710, 76 Stat. 648, amending Code § 172(b) (1) (C).
\item\textsuperscript{58} P.L. 87-834, Revenue Act of 1962, § 24; 76 Stat. 960.
\item\textsuperscript{59} P.L. 87-794, 76 Stat. 883, amending Code § 172(b) (1) (A) (ii).
\item\textsuperscript{60} It is, of course, difficult to draw the line between benefits which are justifiable entirely on grounds of tax administration, without reference to questions of special hardship or the advisability of subsidization, and those which are not justifiable on strictly tax grounds. Some differences in treatment of losses are clearly required where the overall scheme of taxation differs. See, \textit{e.g.,} the discussion of the varying effects on related entities, \textit{supra,} at 251, and Pomeroy, \textit{What Is a Net Operating Loss?}, at 236 \textit{supra}. See also P.L. 87-863, § 5; 76 Stat. 1141.
\end{enumerate}
\end{footnotesize}