TaxNewsFlash

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U.S. Tax Court: Excess loss account included in income of consolidated group member

The U.S. Tax Court today released a memorandum opinion holding that when a subsidiary member of a consolidated group disposes of all of its assets, a member of the consolidated group that owns the subsidiary's stock must include in income for the year of disposition any excess loss account (ELA) with respect to such stock regardless of whether the subsidiary may be entitled to deductions for one or more subsequent years.

The court also held that because the time when a debt will be discharged for federal income tax purposes cannot be predicted in advance, IRS reliance on the taxpayer's representations that each payment required under the terms of certain notes would be canceled six years after the due date demonstrated that the failure of the taxpayer's group to take into account the full cancellation of the notes before 2012 reflected a mutual mistake of law. Consequently, the duty of consistency did not bind the taxpayer to representations that, if accepted as true, would mean that the notes were canceled after December 31, 2011.

The case is: *Belmont Interests v. Commissioner,* T.C. Memo 2022-98 (September 26, 2022). Read the Tax Court's **opinion** [PDF 250 KB]

Summary

The Tax Court summarized the facts in this case as follows:

- The IRS determined deficiencies for the tax years 2012 and 2013 in the federal income tax of the consolidated group of which the taxpayer was the common parent.
- The deficiencies relate to indebtedness (Deficiency Notes) issued by seven members of the group (Loss Subsidiaries).
- The Deficiency Notes required annual installment payments starting in 1993 and matured in full on May 1, 2007.
- In the returns filed for years before 2012, the taxpayer took into account the cancellation of prior installment payments but did not report the Deficiency Notes' full cancellation. The taxpayer later contended that the Deficiency Notes were canceled in full no later than 2011.
- The IRS sought to apply the "duty of consistency" to treat the Deficiency Notes as having been canceled in 2013. On the premise that the Loss Subsidiaries were entitled to deduct accrued interest on the Deficiency

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Notes through 2013, the IRS contended that those subsidiaries cannot be treated, for the purpose of Treas. Reg. § 1.1502-19(c)(1)(iii)(A), as having disposed of all of their assets until 2013.

- On the premise that the Loss Subsidiaries were entitled to deduct accrued interest on the Deficiency Notes through 2013, the IRS contended that those subsidiaries cannot be treated, for the purpose of Treas. Reg. § 1.1502-19(c)(1)(iii)(A), as having disposed of all of their assets until 2013.
- The taxpayer moved for summary judgment, arguing that the duty of consistency does not apply because any errors in its prior reporting of ELAs were attributable to mutual mistakes of law.

The Tax Court held:

- When a subsidiary member of a consolidated group (S) disposes of all of its assets, a member that owns S stock (M) must include in income for the year of disposition any ELA in M's stock in S regardless of whether S may be entitled to deductions for one or more subsequent years. The court cited Treas. Reg. § 1.1502-19(c)(1)(iii)(A).
- Because the time when debt will be discharged for federal income tax purposes cannot be predicted in advance, the IRS reliance on the taxpayer's representations that each payment required under the terms of the Deficiency Notes would be canceled six years after its due date demonstrates that the failure of the taxpayer's group to take into account the full cancellation of the Deficiency Notes before 2012 reflected a mutual mistake of law. Consequently, the duty of consistency did not bind the taxpayer to representations that, if accepted as true, would mean that the Deficiency Notes were canceled after December 31, 2011.

Accordingly, the Tax Court granted the taxpayer's motion for summary judgment, in part.

Also, because the taxpayer had not established that its failure to have reported income from the recognition of ELAs when the Loss Subsidiaries disposed of all their assets and the IRS acquiescence to that reporting were attributable to a mutual mistake of law, the taxpayer's motion for summary judgment was also in part denied.

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