8 T.C. 1286 (1947)

A closing agreement determining tax liability for specific years does not bind the IRS or the taxpayer to the same treatment of specific items or methods used in the computation of tax liability for subsequent tax years.

Summary

The Tax Court addressed whether a closing agreement regarding a corporation's tax liability for 1938 and 1939 precluded the IRS from independently determining the corporation's accumulated earnings and profits when assessing shareholder tax liability in 1941. The court held that the closing agreement, which determined only the total tax liability for those specific years, did not prevent the IRS from re-examining the issue of accumulated earnings in later years. The court reasoned that a closing agreement on total tax liability does not constitute an agreement on each element entering into that calculation.

Facts

Pennsylvania Investment & Real Estate Corporation ("Pennsylvania Corporation") made distributions to its shareholders in 1941. The IRS determined these distributions were taxable dividends. The corporation had acquired assets from T.W. Phillips Gas & Oil Co. in 1928 in a tax-free reorganization. For the years 1938 and 1939, Pennsylvania Corporation claimed dividends paid credits, which were partially disallowed upon audit because the IRS determined that the distributions exceeded the corporation's accumulated earnings and profits. A closing agreement was executed between the corporation and the IRS, finalizing the tax liability for 1938 and 1939. The IRS argued that Pennsylvania Corporation acquired accumulated earnings from T.W. Phillips Gas & Oil Co. in the 1928 reorganization under the rule of *Commissioner v. Sansome*, 60 F.2d 931. The taxpayers, shareholders of Pennsylvania Corporation, argued that the closing agreement precluded the IRS from making that determination.

Procedural History

The IRS assessed deficiencies against the shareholders for the tax year 1941. The shareholders petitioned the Tax Court, arguing that the closing agreement for the tax years 1938 and 1939 precluded the IRS from determining that the distributions were from accumulated earnings. The Tax Court considered the effect of the closing agreement as a preliminary matter.

Issue(s)

Whether a closing agreement determining a corporation's tax liability for specific years (1938 and 1939) precludes the IRS from making an independent determination of the corporation's accumulated earnings and profits in a subsequent tax year (1941) when assessing shareholder tax liability on distributions.

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Holding

No, because a closing agreement as to final tax liability for specific years does not bind the IRS to the same treatment of specific items or methods used in the computation of such tax liability for subsequent tax years.

Court's Reasoning

The court reasoned that the closing agreement, entered into under Section 3760 of the Internal Revenue Code, was meant to finally determine the tax liability of Pennsylvania Corporation for 1938 and 1939 only. The court emphasized that the IRS used Form 866, which relates to the total tax liability of the taxpayer, and merely states that the taxpayer and Commissioner mutually agree that the amount of tax liability which is set forth in the agreement shall be final and conclusive. The court distinguished this from Form 906, which would relate to a final determination covering specific matters. Citing *Smith Paper Co., 31 B.T.A. 28*, affd., *78 F.2d 163*, the court stated that "agreements are localized and limited in their operations by the statute... to tax liabilities for definite periods covered therein... The present agreements closed certain tax liabilities for periods within 1927 and nothing else. The method used in computing the amounts of these liabilities for that year, whether proper or otherwise, could not and did not conclude the respondent in his computation of these disputed tax liabilities for 1928." The court concluded that the closing agreement did not constitute a specific agreement that Pennsylvania Corporation acquired no accumulated earnings or profits from T. W. Phillips Gas & Oil Co. in the nontaxable reorganization under the rule of the *Sansome* case.

Practical Implications

This case clarifies the scope of closing agreements, particularly those executed on Form 866. It serves as a caution to taxpayers that such agreements, while providing certainty for the specified tax years, do not necessarily protect them from re-examination of underlying issues in future years. Taxpayers seeking to definitively resolve specific issues, such as the characterization of earnings and profits, should pursue a closing agreement on Form 906, which specifically addresses particular items. The case highlights the importance of understanding the limited scope of a general closing agreement and the need for more specific agreements when seeking to resolve particular tax issues definitively for all future years. Subsequent cases have cited this case for the proposition that closing agreements are narrowly construed to only cover the specific tax years and liabilities addressed.

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