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ELEMENTS OF CAPITAL GAIN — GENERAL (cont'd)
MEANING OF "HELD MORE THAN SIX MONTHS"

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The general rule is that an asset must be held not merely six months but "more than six months" for its disposition to qualify for long term capital gain treatment.[1] "More than 6 months" does not mean more than half a year or more than 182 days. A holding period of 182 days may qualify and one of 184 days may fail to qualify.

In these days of fluctuating prices and client pressure a lawyer must compute holding periods exactly, for a client may not wish to delay a day in realizing his long term capital gain and a sale that is a day too soon will mean taxation at ordinary income rates.

ORDINARY PURCHASE OR SALE

Perhaps the first problem is a determination of when the holding period commences and when it ends in the normal case of a purchase and sale.[2] If a taxpayer buys an asset at noon on Tuesday and sells it at 11:00 a. m. Thursday has he held it for two days? The answer, fortunately, is yes. The computation is not concerned with the time of day that an asset is bought or sold. That problem is eliminated by rough (and administratively feasible) justice: the day of purchase is excluded and the day of sale is included in the holding period.[3] Hence, taxpayer held the asset for two days.

The second problem is: how long is more than six months? The answer cannot be given simply but begins with the consideration that the holding period is concerned with months and fractions thereof rather

1. See INT. REV. CODE OF 1954, § 1222(3). (Hereinafter cited as §). There are many special provisions, having to do with specific types of property or transactions, where the general rules are varied. For example: long term gain treatment is provided for certain patent dispositions regardless of actual holding period. § 1235(a); see Edward C. Myers, 6 T.C. 258 (1946), *acq.*, 1958-2 CUM. BULL. 6 (normal rule on patents); § 1233 (short sales); § 735(b) (holding period of property distributed by partnerships). Many such special provisions are discussed in other articles in this series or noted at other points herein.

2. On determining when a sale occurs for purposes of the holding period computation see discussion pp. 293-99.

3. *But see* I.T. 3985, 1949-2 CUM. BULL. 51, 52, which states that the rule "does not require exclusion particularly of either the beginning date or the ending date of the period but merely of *one* day . . . so as to eliminate duplication and avoid computations of fractions of days." Nevertheless, the rule is usually stated to require exclusion of the date of purchase. *E.g.*, Fogel v. Commissioner, 203 F.2d 347 (5th Cir. 1953); I.T. 3287, 1939-1 CUM. BULL. 138; 3B MERTENS, LAW OF FEDERAL INCOME TAXATION § 22.104 at 440-41 (1958).

than with days. A month means a calendar month regardless of whether it has 28, 29, 30 or 31 days. And a calendar month means a period ending on the day of the succeeding month corresponding to the day of the beginning of the period (*i.e.,* the day after purchase), less one. Thus, if an asset is purchased on March 15th and sold on April 15th it has been held for exactly one month (from March 16th to April 15th inclusive). Where the succeeding month does not have a date corresponding to the date of the beginning of the holding period the "month" ends with the last day of the succeeding month. Thus an asset purchased on January 30th and sold on February 28th has been held for one month (except in a leap year when it would have to be held until February 29th).

Putting these rules together, it can be seen that an asset purchased on September 15th and sold on March 16th has been held for more than six months, although the holding period comprises only 182 days; an asset purchased on May 1st and sold on November 1st has not been held more than six months although the holding period comprises 184 days.[4]

The above rules explain computation of the holding period in the normal situation. There can be complications, however.[5] If an asset is purchased on September 30th and sold on March 31st, has it been held six months or six months and a day? It seems that if the day of purchase is excluded it would be considered to be held only six months (from October 1st to March 31st). Whereas, if the date of sale is excluded it would be held longer than six months (from September 30th to March 30th). A private ruling issued in 1953 takes the position that the asset has been held more than six months, and also states that the day of purchase *is* excluded.[6] Despite this ruling and the policy statement mentioned previously[7] (that the rule does not require exclusion particularly of either the beginning date or the ending date but only of one day), caution dictates holding an extra day in this situation.

SECURITIES EXCHANGE TRANSACTIONS

Perhaps the area where exact computation of the holding period is most often required is that of the purchase and sale of securities on the securities exchanges. Such transactions usually are not completed in one day. The purchase or sale is executed on the floor of the exchange on one day and settlement is made by delivery of certificates and cash on a

4. See E. T. Weir, 10 T.C. 996 (1948), *aff'd per curiam,* 173 F.2d 222 (3d Cir. 1949).

5. I.T. 3985, 1949-2 CUM. BULL. 51, sets out special rules for computing fractions of months in cases under the "wash sale" provisions where two separate periods must be added together to form one holding period.

6. 5 CCH 1953 STAND. FED. TAX REP. ¶ 6306.

7. I.T. 3985, 1949-2 CUM. BULL. 51, note 3 *supra.*

subsequent day — usually four business days later. The Internal Revenue Service has ruled that the holding period commences the day after the purchase order is executed on the exchange — not on the later settlement date.[8] And the holding period terminates on the day the sales order is executed.

TACKING OF HOLDING PERIODS

Ordinarily, the holding period on each individual piece of property owned by the taxpayer must be computed separately and with reference only to the period of time during which he held that property. For example, if the taxpayer first purchases an option on certain land and later exercises his option, his holding period for the land does not include the period he held the option.[9] If he later constructs a building on the land, his holding period for the land is longer than that for the building.[10] And if the building is disposed of more than six months after its construction was started, but less than six months after its completion, a portion of the gain on the building — but only a portion — will be considered long term gain.[11]

Carryover of Basis

In certain circumstances specifically provided by statute, however, the holding period is not determined solely by the length of time the taxpayer held the particular property involved; an additional period is added. Depending on the circumstances, the additional period may be either the period during which the property was held by a former holder or the period of time the taxpayer held another item of property. The first major area where this "tacking" of holding periods applies is in an exchange of property in which the taxpayer's basis for the property exchanged becomes the basis for the property received.[12] This carryover of basis occurs in the type of exchange usually referred to as "tax-free";

8. I.T. 3705, 1945 CUM. BULL. 174 (the postponement of settlement date by intervening holidays does not alter the rule). As to "when issued" securities, see I.T. 3721, 1945 CUM. BULL. 164, 173. As to identification of securities sold where some shares have been held more than six months and some have not, see Treas. Reg. §§ 1.1223-1(i), 1.1012-1(c); Helvering v. Rankin, 295 U.S. 123 (1935); discussion pp. 300-02.

9. E. T. Weir, 10 T.C. 996 (1948), *aff'd per curiam*, 173 F.2d 222 (3d Cir. 1949); *accord*, Max H. Wyman, 33 T.C. No. 70 (1959); *cf.* § 1223(6) (stock acquired through exercise of rights).

10. Paul v. Commissioner, 206 F.2d 763 (3d Cir. 1953); Dunigan v. Burnet, 66 F.2d 201 (D.C. Cir. 1933); W. H. Weaver, 32 T.C. 411 (1959); I.T. 2469, VIII-1 CUM. BULL. 158 (1929).

11. Paul v. Commissioner, 206 F.2d 763 (3d Cir. 1953); Fred Draper, 32 T.C. 545 (1959).

12. See § 1223(1). To qualify, the property surrendered in the exchange must be a capital asset or a § 1231 asset (real property or depreciable property used in a trade or business). Section 1223(1) expressly applies to two types of transactions which may not involve an actual exchange: involuntary conversions under § 1033 and distributions to which § 353 applies.

many types of such exchanges are provided by various sections of the Code. When a taxpayer engages in one of these transactions, his holding period for the property he receives will be extended by the length of time he held the property which was surrendered in the exchange. For example, taxpayer purchases common stock in the *A* Company and at some time thereafter *A* Company is merged into the *B* Company. The merger qualifies as a reorganization under section 368(a)(1)(A). Upon merger, the taxpayer receives common stock of the *B* Company in exchange for his *A* Company stock. This constitutes a tax-free exchange.[13] Taxpayer's basis for the *A* stock becomes his basis for the *B* stock.[14] Accordingly, in computing his holding period of *B* stock, the taxpayer must add the period of time during which he held the *A* stock to the time he held *B* stock as such.

The second major area where tacking is required is where the taxpayer acquires property from another person in a transaction such that the other person's basis for the property carries over and becomes taxpayer's basis.[15] In this situation, the period during which the transferor held the property is added to taxpayer's holding period. A transfer by gift illustrates this provision. *A* owns property with a basis of $100 and a fair market value of $200. *A* gives the property to *B*. Under these facts section 1015 provides that *A*'s basis will carry over to *B*. Thus *B*'s basis will be $100. Since *B*'s basis is determined by *A*'s basis he must add *A*'s holding period to his own.[16]

The gift situation should be contrasted with a transfer by inheritance. The basis of inherited property is determined not by decedent's basis but by the fair market value of the property at the date of death or at the optional valuation date. Accordingly, the holding period of the decedent may not be tacked to that of the recipient. The recipient's holding period begins at the date of death of the decedent.[17]

13. § 354(a).

14. § 358(a).

15. See § 1223(2). Other paragraphs of § 1223 set forth several other situations, of more limited applicability, where tacking of holding periods is allowed, *e.g.*, where gain on sale of a residence is not recognized under § 1034.

16. If the fair market value of the property is less than the donor's basis at the time of the gift, the donor's basis does not carry over for purposes of determining loss on a subsequent sale. Consequently, in such a case there will be no tacking of holding period. I.T. 3453, 1941-1 CUM. BULL. 254.

17. McFeely v. Commissioner, 296 U.S. 102 (1935).