¶6 2015 Tax Calendar

Each date shown below is the last day for filing the return or making the payment of tax indicated. For income tax returns, the due dates apply to calendar-year taxpayers only. Employment tax due dates are determined on a calendar-year basis for all taxpayers. **If any statutory due date falls on a Saturday, Sunday, or legal holiday, the due date is the next succeeding day that is not a Saturday, Sunday, or legal holiday (national, District of Columbia, or statewide in the state where the return is to be filed).**

This day 2015	Tax Return Due Dates
Jan. 15th—	**Estimated Taxes.** Final installment of 2014 estimated tax (Form 1040-ES) by individuals unless income tax return is filed with final payment by February 2, 2015. Payment in full of estimated tax by farmers and fishermen unless income tax returns are filed by March 2, 2015.
	Final installment of 2014 estimated tax (Form 1041-ES) by trusts, calendar-year estates, and certain residuary trusts in existence more than two years, unless Form 1041 is filed and taxes are paid in full by February 2, 2015.
Feb. 2nd—	**Employers' Taxes.** Employers of nonagricultural and nonhousehold employees file return on Form 941 for withheld income and FICA taxes in last quarter of 2014.[1]
	Employers of agricultural workers must file the annual Form 943 to report income and FICA taxes withheld on 2014 wages.[1]
	Employers must file Form 940, annual return of federal unemployment (FUTA) taxes for 2014.[1]
	Withholding. Employees' statements (Form W-2 and Form 1099-R) for amounts withheld in 2014 to be furnished by employer to employees.
	Individuals. Individuals, other than farmers and fishermen, who owed, but did not pay, estimated tax on January 15th must file final 2014 income tax return and pay tax in full to avoid late payment penalty.
	Trusts and Estates. Trusts, as well as estates and certain residuary trusts in existence more than two years, that owed but did not pay estimated tax on January 15th must file final 2014 income tax return and pay tax in full to avoid late payment penalty.
	Information Returns. Annual statements must be furnished to recipients of: dividends and liquidating distributions (Form 1099-DIV); interest, including interest on bearer certificates of deposit (Form 1099-INT); patronage dividends (Form 1099-PATR); original issue discount (Form 1099-OID); certain government payments, including unemployment compensation and state and local tax refunds of $10 or more (Form 1099-G); royalty payments of $10 or more, rent or other business payments of $600 or more, prizes and awards of $600 or more, crop insurance proceeds of $600 or more, fishing boat proceeds, and medical and health care payments of $600 or more (Form 1099-MISC); debt canceled by certain financial entities including financial institutions, credit unions, and Federal Government agencies of $600 or more (Form 1099-C); distributions from retirement or profit-sharing plans, IRAs, SEPs, or insurance contracts (Form 1099-R); payments received from a third party settlement entity (Form 1099-K).
	Business recipients of $600 or more of interest on any mortgage must furnish Form 1098 to payer.
	Information called for on Form 8300 must be provided to each payer in a transaction of more than $10,000 in cash at any time during 2014. (Form 8300 must have been filed with the IRS by the 15th day after the date of the transaction.)

This day 2015	Tax Return Due Dates
	Partnerships must provide Form 8308 to the transferor and transferee in any exchange of a partnership interest that involved unrealized receivables or substantially appreciated inventory items.
	Trustees or issuers of IRAs or SEPs must provide participants with a statement of the account's value.
Feb. 17th—	**Individuals.** Last day for filing Form W-4 by employees who wish to claim exemption from withholding of income tax for 2015.
	Information Returns. Annual statements must be furnished to recipients of proceeds from broker and barter exchange transactions (Form 1099-B); proceeds from real estate transactions (Form 1099-S); broker payments in lieu of dividends or tax-exempt interest, and gross proceeds paid to an attorney (Form 1099-MISC).
Mar. 2nd—	**Information Returns.** Annual 1099 series returns (together with transmittal Form 1096) for paper filings or, if filing electronically, by March 31, must be filed with the IRS to report payments to recipients who received Form 1099 on January 31st, as indicated above.
	Business recipients of $600 or more of interest from an individual on any mortgage must file Form 1098 with the IRS (together with transmittal Form 1096) for paper filings or, if filing electronically, by March 31st.
	Withholding. Form W-2 "A" copies for 2014 (together with transmittal Form W-3) must be filed with the Social Security Administration. If filing electronically, the due date is extended to March 31st.
	Form W-2G and Form 1099-R for 2014 "A" copies (together with transmittal Form 1096) for paper filings or, if filing electronically, by March 31st, must be filed with the IRS.
	Individuals. Last day for farmers and fishermen who owed, but did not pay, estimated tax on January 15th to file 2014 calendar-year income tax return and pay tax in full to avoid late payment penalty.
Mar. 16th—	**Corporations.** Due date of 2014 income tax returns (Form 1120) for calendar-year U.S. corporations or calendar-year foreign corporations with offices in the United States. Fiscal-year U.S. corporations and foreign corporations with a U.S. office must file by the 15th day of the 3rd month following the close of the tax year.
	Last date for filing application (Form 7004) by calendar-year corporations for automatic six-month extension to file 2014 income tax return.
	Form 5452 for reporting nontaxable corporate distributions made to shareholders during calendar year 2014 should be filed by calendar-year corporations with income tax return. Fiscal-year corporations file Form 5452 with income tax return for first fiscal year ending after calendar year in which distributions were made.
	Calendar-year corporations' 2014 information return (Form 5471) with respect to foreign corporations. (Fiscal-year corporations file form with income tax return.)
	Last date for a calendar-year corporation to file an amended income tax return (Form 1120X) for the calendar year 2011.[2]
	S Corporations. Due date of 2014 income tax returns for calendar-year S corporations (Form 1120S) and to provide each shareholder with a copy of Schedule K-1.
	Last date for filing application (Form 7004) by S corporations for automatic six-month extension to file 2014 income tax return.
	Last date for filing Form 2553 to elect to be treated as an S corporation beginning with calendar year 2015. The penalty for filing the election late is to postpone treatment as an S corporation until calendar year 2016.

investment income had it been earned directly by the shareholder is considered net investment income to the shareholder. In addition, if the S corporation is engaged in the trade or business of a trader trading in financial instruments or commodities, the income or loss from that trade or business is excluded from the shareholder's NII without regard to whether the shareholder is himself engaged in the trade or business.

Dispositions of S Corporation Stock. Net gain or loss upon the disposition of S corporation stock is considered net investment income only to the extent it would be taken into account as such by the shareholder if all S corporation property were sold at fair market value immediately before the disposition (Code Sec. 1411(c)(4); Proposed Reg. §1.1411-7).[42] Specifically, gain or loss from property used in the S corporation's trade or business is excluded from NII for purposes of the tax, unless the trade or business is a passive activity with respect to the shareholder or involves trading in financial instruments or commodities.

315. Basis in S Corporation Stock. An S corporation shareholder's basis in his or her stock is determined under the same rules that apply to C corporation shareholders. Thus, the original basis of the shareholder's stock is the purchase price for the stock (money or the fair market value of any property given in exchange for the stock) (Code Sec. 1012).[43] Stock acquired by gift normally carries over the donor's basis (¶ 1630). The basis of stock acquired from a decedent is its fair market value on the date of the decedent's death or on the alternate valuation date, if elected (¶ 1633). During the time the corporation is an S corporation, each shareholder must make adjustment to his or her stock (¶ 317).

Similarly, the rules providing for contributions to controlled corporations under Code Sec. 351 (¶ 203) and tax-free corporate reorganizations under Code Sec. 368 (¶ 2209) are generally applicable to S corporations (Code Sec. 1371).[44] Thus, the basis of stock received under a tax-free reorganization is equal to the transferor's basis in the property transferred, plus any gain, minus the fair market value of the boot received, and minus any loss recognized in the transaction.

Stock for Services. An S corporation may grant stock to an employee or other service provider as part of a compensation package. Typically, in a stock-for-services arrangement, S corporation stock may be transferred to an employee at a particular price or for nothing, with the rights to the stock becoming vested only after a number of years of employment. The value of the S stock at that vesting point has usually appreciated from its value at the time of transfer. The difference between the amount that the employee pays for the S stock and the fair market value of the stock at the time the employee's rights to the stock are vested must be included in the employee's ordinary gross income (¶ 713). The S corporation gets a compensation deduction for the amount the employee includes in income in the year the employee includes it in income.

317. Adjustments to Basis in S Corporation Stock. The stock basis of each S corporation shareholder (¶ 315) is *increased* by the shareholder's portion of:

(1) all income items of the corporation (including tax-exempt income) that are separately computed and passed through to shareholders;

(2) the income of the corporation that is not separately computed; and

(3) the excess of the corporation's deductions for depletion (¶ 1289) over the basis of the property subject to depletion (Code Sec. 1367(a)(1); Reg. §1.1367-1(b)).[45]

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[42] ¶ 32,602, ¶ 32,604N; INDIV: 69,160.40; § 1,022.15
[43] ¶ 29,330; SALES: 6,050; § 28,605.10
[44] ¶ 32,140; CCORP: 3,202, CCORP: 39,256; § 26,130
[45] ¶ 32,100, ¶ 32,100B; SCORP: 410.05; § 28,610.05

A shareholder's basis is *decreased* by the portion of:

(1) distributions that are not includible in the shareholder's income (¶ 309);

(2) all loss and deduction items of the corporation that are separately stated and passed through to shareholders (but see the discussion below with respect to charitable contributions of appreciated property);

(3) the nonseparately computed loss of the corporation;

(4) any expense of the corporation not deductible in computing its taxable income and not properly chargeable to capital account; and

(5) the amount of the shareholder's deduction for depletion with respect to oil and gas wells to the extent that it does not exceed his or her proportionate share of the adjusted basis of such property (Code Sec. 1367(a)(2); Reg. §1.1367-1(c)).[46]

If a shareholder's stock basis is reduced to zero, the remaining net decrease attributable to losses and deductions is applied to reduce any basis in debt owed to the shareholder by the corporation (¶ 318). Distributions may not be applied against basis in debt. Any net increase in basis in a subsequent year is applied to restore the basis of indebtedness before it may be applied to increase the shareholder's stock basis.

Generally, stock basis adjustments are determined as of the close of the corporation's tax year, and the adjustments are effective as of that date. However, if a shareholder disposes of stock during the corporation's tax year, the adjustments with respect to that stock are effective immediately before the disposition (Reg. §1.1367-1(d)).[47] An adjustment for a nontaxable item is determined for the tax year in which the item would have been includible or deductible under the corporation's method of accounting for federal income tax purposes if the item had been subject to federal income taxation.

Charitable Deductions. For tax years beginning before January 1, 2014, the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution of property made by the corporation equals the shareholder's pro rata share of the adjusted basis of the contributed property (Code Sec. 1367(a)(2)).

Planning Note: Absent further legislation, the reduction of an S corporation shareholder's outside basis by the shareholder's pro rata share of the basis of contributed property will not apply for contributions made in tax years beginning after December 31, 2013. For the latest legislative updates, visit our website, www.CCHGroup.com/TaxUpdates.

Cancellation of Indebtedness. Discharge of indebtedness income of an S corporation that is excluded from the corporation's income (¶ 855) is not taken into account as an item of income that flows through to any shareholder (¶ 309) and so does not increase a shareholder's basis in S corporation stock (Code Sec. 108(d)(7)(A); Reg. §1.108-7(d)).[48]

318. Basis in S Corporation Debt. For purposes of deducting S corporation losses, a shareholder has basis in certain debts of the S corporation to the shareholder (Code Sec. 1366(d)(1)(B); Reg. §1.1366-2(a)(2)).[49] Under final regulations that apply to indebtedness between an S corporation and its shareholder resulting from any transaction occurring on or after July 22, 2014, the debt in question must run directly to the shareholder and represent a bona fide indebtedness of the S corporation. Federal tax principles generally determine whether indebtedness is bona fide, based on all relevant facts and circumstances. Unlike a partner in a partnership, an S corporation shareholder does not receive basis or an increase in basis for debt of the S corporation to an outside lender. A mere guaranty by the shareholder of the S corporation's debt to a third party also does not qualify for an increase in the shareholder's basis, including acting as a surety, accommodation party, or in any similar capacity relating to the loan.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[46] ¶ 32,100, ¶ 32,100B; SCORP: 410.05; § 28,615
[47] ¶ 32,100B; SCORP: 410.05; § 28,620
[48] ¶ 7002, ¶ 7006; SALES: 12,212.10, SCORP: 404.10; § 28,610.10
[49] ¶ 32,080, ¶ 32,082; SCORP: 404.05; § 28,630.05, § 28,630.10

W-2 Wage Limitation. A partner computes the W-2 wage limitation for the Code Sec. 199 deduction by aggregating its share of W-2 wages from the partnership allocable to DPGR with its W-2 wages allocable to DPGR from other sources.

432. Members' Dealings with Own Partnership. Transactions between a partnership and partner may be deemed to be between a partnership and a nonpartner under certain circumstances (Code Sec. 707(a)).[77] This rule prevents the use of disguised payments to circumvent the requirement that a partnership capitalize certain expenses (such as syndication and organization expenses).

Disguised Sales. In order to prevent such manipulation, the Code provides that if:

(1) a partner performs services for a partnership or transfers property to a partnership,

(2) there is a related direct or indirect allocation and distribution to the partner, and

(3) the performance of the partner's service (or the partner's transfer of property) and the allocation and distribution, when viewed together, are properly characterized as a transaction that occurred between the partnership and the partner acting as a nonpartner,

then, for income tax purposes, the transaction is treated as if it occurred between the partnership and a nonpartner (Code Sec. 707).[78]

If this provision applies to a transaction, then the allocation and distribution made by the partnership to the partner is recharacterized as a payment for services or property and, where required, the payment must be capitalized or otherwise treated in a manner consistent with its recharacterization. The partners' shares of taxable income or loss must then be redetermined.

Whether a transfer constitutes a disguised sale is based on facts and circumstances. However, contributions and distributions made within a two-year period are presumed to be a sale, while such transactions occurring more than two years apart are presumed not to be a sale (Reg. §1.707-3(c) and (d)).[79] Exceptions to these presumptions are provided for guaranteed payments for capital, reasonable preferred returns, and operating cash flow distributions (Reg. §1.707-4).[80]

Transactions Between Controlled Partnerships. Special rules also apply to controlled partnerships. Loss is not allowed from a sale or exchange of property (other than an interest in the partnership) between a partnership and a person whose interest in the partnership's capital *or* profits is more than 50 percent. Loss is also not allowed if the sale or exchange is between two partnerships in which the same persons own more than 50 percent of the capital or profits interests (Code Sec. 707(b)(1)).[81] In either case, if one of the purchasers or transferees realizes gain on a later sale, the gain is taxable only to the extent it exceeds the amount of the disallowed loss attributable to the property sold. Gain recognized on transactions involving controlled partnerships is treated as ordinary income if the property sold or exchanged is not a capital asset in the hands of the transferee (Code Sec. 707(b)(2)).[82]

Code Sec. 267(a)(1) disallows deductions for losses from the sale or exchange of property between related persons described in Code Sec. 267(b), including a partnership and a corporation controlled by the same persons (¶ 1717). Although this loss-denial rule does not apply to a transaction between a partnership and a partner, it does apply to a transaction between a partnership and a person who has a relationship with a partner that is otherwise specified in Code Sec. 267(b) (Reg. §1.267(b)-1(b)).[83] Under Code Sec. 267(a)(2), accrued interest and expense deductions are not deductible until paid if the

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[77] ¶ 25,180; PART: 27,050; §30,701
[78] ¶ 25,180; PART: 27,058; §30,715.05
[79] ¶ 25,181B; PART: 27,058.05; §30,715.15, §30,715.20
[80] ¶ 25,181C; PART: 27,058.10; §30,715.25
[81] ¶ 25,180; PART: 27,152; §30,720.10
[82] ¶ 25,180; PART: 27,154; §30,720.15
[83] ¶ 14,153; PART: 27,152; §30,720.10

amount giving rise to the deduction is owed to a related cash-method taxpayer. For purposes of this rule, a partnership and persons holding interests in the partnership (actually or constructively) or persons related (under Code Sec. 267(b) or 707(b)(1)) to actual or constructive partners are treated as related persons (¶ 905 and ¶ 1540B) (Code Sec. 267(e)(1)).[84]

Sale and Liquidation of Partner's Interest

434. Purchase or Sale of a Partnership Interest. The sale or exchange of a partnership interest generally is treated as the sale of a single capital asset rather than a sale of each of the underlying partnership properties (Code Sec. 741).[85] The amount of gain or loss is based on the partner's basis in his or her partnership interest and the amount realized on the sale (Code Sec. 721).[86] The sale of a partnership interest to a partner or to a nonpartner should be distinguished from the redemption of a partner's interest by the partnership (¶ 435).

Despite the general rule that the gain or loss on the sale of a partnership interest is a capital gain or loss, a partner may recognize ordinary income or loss under the constructive sale rules if he or she receives a disproportionate distribution of partnership unrealized receivables or inventory (¶ 430).

If a partner abandons or forfeits his or her partnership interest, the partner recognizes a loss equal to their basis in the partnership interest. Thus, a partner with a zero basis in its partnership interest is not allowed an abandonment loss (*E.J. LeBlanc*, FedCl, 2010-1 USTC ¶ 50,104). If the partnership has liabilities, the abandoning partner is deemed to have received a distribution from the partnership when he or she is relieved of the liabilities. In such a case, the partner's loss is the basis in his or her interest less any liabilities of which the partner is relieved. An abandonment of a partnership interest, if there are no partnership liabilities from which the partner is relieved, results in an ordinary loss because no sale or exchange has taken place (*P.B. Citron*, Dec. 97 TC 200 (1991); *G.G. Gannon*, Dec. 16 TC 1134 (1951)).[87] If there are partnership liabilities of which the abandoning partner is relieved, the resulting gain or loss is a capital gain or loss (*A.O. Stilwell*, Dec. 46 TC 247 (1966)).[88] Even a *de minimis* actual or deemed distribution generally results in a capital loss treatment to the partner. Capital loss is also mandated if the transaction is, in substance, a sale or exchange (Rev. Rul. 93-80).[89]

For purposes of the 3.8-percent net investment income tax, net gain or loss upon the disposition of a partnership interest is considered net investment income only to the extent it would be taken into account by the partner if all partnership property were sold at fair market value immediately before the disposition (¶ 129) (Code Sec. 1411).[90]

Unrealized Receivables and Inventory. A partner recognizes ordinary income or loss on any portion of a sale of a partnership interest that is attributable to his or her share of the partnership's unrealized receivables and inventory (¶ 436) (Code Sec. 751(a)).[91] The gain is measured by the portion of the selling price attributable to unrealized receivables and inventory and the partner's basis in these assets. The partner's basis is the basis the partner's share of partnership unrealized receivables and inventory would have if these assets were distributed to the partner in a current distribution (Reg. §1.751-1(a)(2)).[92] Capital gain or loss is determined by subtracting the partner's remaining basis from the rest of the amount realized (Reg. §1.741-1(a)).[93]

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[84] ¶ 14,150; PART: 27,160; §30,730.05
[85] ¶ 25,440; PART: 39,050; §30,905.05
[86] ¶ 25,240; PART: 39,052, PART: 39,054; §30,905.05
[87] ¶ 25,442.12, ¶ 25,422.545; PART: 39,058.05; §30,905.45, §30,905.50
[88] ¶ 25,422.545; PART: 39,058.10; §30,905.10
[89] ¶ 25,442.12; PART: 36,104.15; §30,905.45
[90] ¶ 32,602; INDIV: 69,156; §1,022.10
[91] ¶ 25,500; PART: 42,050; §30,905.25
[92] ¶ 25,501; PART: 42,054; §30,905.25
[93] ¶ 25,441; PART: 42,052; §30,905.25

556. Taxation of Beneficiary of Estate or Complex Trust. A beneficiary of a complex trust (¶ 542) or a decedent's estate must include in gross income the income that is required to be distributed currently to the beneficiary (¶ 514), whether or not it is actually distributed during the tax year, plus any other amounts that are properly paid, credited, or required to be distributed to the beneficiary for the year (Code Sec. 662; Reg. § 1.662(a)-1).[128] For example, income of a trust is taxable to the beneficiaries even where there is no direction as to distribution or accumulation and state law requires distribution.[129] If a fiduciary elects to treat a distribution to a beneficiary made in the year as an amount paid in a prior year (¶ 546), the amount covered by the election is included in the beneficiary's income for the year for which the trust takes the deduction. Special rules also apply to distributions by certain trusts out of accumulated income (¶ 567).

If the amount of income required to be distributed currently to all beneficiaries exceeds distributable net income (DNI) (¶ 543) (computed without the charitable deduction (¶ 537)), then each beneficiary includes in income an amount that bears the same ratio to DNI as the amount of income required to be distributed currently to the beneficiary bears to the amount required to be distributed currently to all beneficiaries (Reg. § 1.662(a)-2(b)).[130]

If the sum of income required to be distributed currently, plus other amounts properly paid, credited, or required to be distributed, exceeds DNI, then the beneficiary includes such other amounts in gross income only to the extent that DNI exceeds income required to be distributed currently (Reg. § 1.662(a)-3(c)).[131] If the other amounts are paid, credited, or required to be distributed to more than one beneficiary, each beneficiary includes in gross income his or her proportionate share of such other amounts includible in gross income. The beneficiary's proportionate share is the amount which bears the same ratio to DNI (after subtracting income required to be distributed currently) as the other amounts distributed to the beneficiary bear to the other amounts distributed to all beneficiaries. The amount to be used in determining the beneficiary's share of estate or trust income depends on whether the estate or trust elected to recognize gain on the distribution (¶ 526).

Any amount which, under a will or trust instrument, is used in full or partial discharge or satisfaction of a legal obligation of any person is included in that person's gross income as though the amount was directly distributed to him or her as a beneficiary (Reg. § 1.662(a)-4).[132] A legal obligation includes an obligation to support another person only if it is not affected by the adequacy of the dependent's own resources. The amount of trust income included in the gross income of a person obligated to support a dependent is limited by the extent of the person's legal obligation under local law. For example, in the case of a parent's obligation to support his or her child, to the extent that the support obligation (including education) is determined under local law by the family's station in life and the means of the parent, it is determined without consideration of the trust income in question. This rule does not pertain to alimony payments or income of an alimony trust (¶ 771).

If a net operating loss carryback of the estate or trust (¶ 531) reduces the DNI of the estate or trust for the prior tax year to which the NOL is carried, the beneficiary's tax liability for the prior year may be recomputed based upon the revised DNI of the estate or trust (Rev. Rul. 61-20).[133]

In allocating the various types of income to the beneficiaries so as to give effect to these tax rules, the amount reflected in the trust's or estate's DNI is determined first. It is charged with directly related expenses and a proportionate part of other expenses, including the unlimited charitable deduction (¶ 537) to the extent it is chargeable to

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[128] ¶ 24,420, ¶ 24,421; ESTTRST: 30,000; § 32,710.05
[129] ¶ 24,431.65; ESTTRST: 24,052.05; § 32,710.05
[130] ¶ 24,422; ESTTRST: 30,108; § 32,710.05
[131] ¶ 24,423; ESTTRST: 30,154; § 32,710.05
[132] ¶ 24,424; ESTTRST: 30,052; § 32,710.05
[133] ¶ 24,431.493; ESTTRST: 12,062; § 32,410

income of the current year (Reg. §§ 1.662(b)-1 and 1.662(b)-2).[134] Each beneficiary's share of income paid, credited, or required to be distributed to the beneficiary is then multiplied by fractions, for each class of income, in which the numerator is the amount of such income included in DNI (whether the aggregate is more or less than the DNI), and the denominator is the total DNI (¶ 545). However, if the governing instrument specifies or local law requires a different allocation, such allocation is to be followed. These computations are illustrated at ¶ 559.

Special provisions exclude certain amounts from the beneficiary's gross income (and from the estate or trust's distribution deduction) (Code Sec. 663(a); Reg. §§ 1.663(a)-1, 1.663(a)-2, and 1.663(a)-3).[135] Any amount paid, permanently set aside, or to be used for charitable purposes and allowable for the unlimited charitable deduction (¶ 537) cannot be part of the distribution deduction or treated as an amount distributed for purposes of determining the beneficiary's gross income. Additionally, amounts deemed to be distributed to a beneficiary in a *prior* tax year cannot be deducted by the estate or trust, and are not included in the beneficiary's gross income for the current tax year. Certain gifts or bequests of a specific sum of money or specific property if paid or distributed all at once or in not more than three installments are also excluded (¶ 564).

On termination of an estate or trust, unused loss carryovers and excess deductions of the estate or trust are allowed to certain beneficiaries (¶ 535).

The amounts reported on the beneficiary's return must be consistent with the amounts reported on the estate or trust return (¶ 2823) (Code Sec. 6034A(c)).[136]

Net Investment Income Tax. For purposes of determining the 3.8-percent net investment income tax (¶ 129), net investment income includes a beneficiary's share of DNI to the extent that the character of such income constitutes gross income from certain income items (e.g., interest, dividends, annuities, royalties, rents, gross income from a passive trade or business or from a trader's financial instrument trading business, etc.) or net gain attributable to the disposition of certain property, with further computations for the estate's or trust's undistributed net investment income (¶ 517) (Reg. § 1.1411-4(e)(1)).[137]

557. Separate Shares as Separate Estates or Trusts. Where an estate or trust has two or more beneficiaries and is to be administered in well-defined and separate shares, the shares must be treated as separate estates or trusts in determining the amount of distributable net income (DNI) allocable to the beneficiaries (¶ 554 and ¶ 556) (Code Sec. 663(c); Reg. §§ 1.663(c)-1—1.663(c)-5).[138] This rule limits the tax liability of a beneficiary on a distribution of income and corpus where the income is being accumulated for the benefit of another beneficiary. The separate-share treatment is mandatory, not elective. A trustee or an executor must apply it even if separate and independent accounts are not maintained for each share, or if assets are not physically segregated.

The separate-share rule does not affect situations in which a single trust instrument creates not one, but several separate trusts, as opposed to separate shares in the same trust. It also does not apply to trusts that provide for successive interests (e.g., a trust that provides a life estate to A and remainder to B).

The treatment of separate shares as separate estates or trusts applies *only* for determining DNI in computing the distribution deduction allowable to the estate or trust and the amount includible in the income of the beneficiary. It cannot be applied to obtain more than one deduction for the personal exemption or to split the income of the estate or trust into several shares so as to be taxed at a lower-bracket rate.

559. How the Complex Trust Rules Operate. The examples below illustrate computations of distributable net income (DNI) (¶ 543), the distributive share of a beneficiary (¶ 544 and ¶ 545), and the taxable income of a complex trust. No "throwback" distributions (¶ 567) are involved.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[134] ¶ 24,425, ¶ 24,426; ESTTRST: 30,106; § 32,710.05
[135] ¶ 24,440—¶ 24,443; ESTTRST: 27,100; § 32,710.05, § 32,710.15
[136] ¶ 35,460; ESTTRST: 100; § 32,701
[137] ¶ 32,604; ESTTRST: 12,256.10; § 32,710.05
[138] ¶ 24,440, ¶ 24,446—¶ 24,449; ESTTRST: 27,200; § 32,515.20

Funded Arrangements. If deferred compensation is contributed to a trust or is used to purchase an annuity or other insurance contract, the arrangement is funded and a participant may be subject to tax on the trust's income (¶ 2199).

Unfunded Arrangements. If the deferral takes the form of an employer's unsecured promise (i.e., not represented by a note) to pay compensation for current services at some time in the future, and if the employee uses the cash method of accounting, the amount promised is not includible in the employee's gross income until it is received or made available (¶ 906) (Rev. Rul. 60-31, modified by Rev. Rul. 64-279 and Rev. Rul. 70-435).[53] This rule is not altered merely because the employee agrees with the employer in advance to receive compensation on a deferred basis, so long as the agreement is made before the taxpayer obtains an unqualified and unconditional right to the compensation (*J.F. Oates*, CA-7, 53-2 USTC ¶ 9596).[54]

Unfunded Plans of State and Local Governments and Other Tax-Exempt Organizations. The above-described treatment of unfunded deferred compensation plans is modified for participants in plans maintained by state and local governments and other tax-exempt organizations, except for churches and qualified church-controlled organizations (Code Sec. 457).[55] For distributions from an eligible nongovernment plan, the deferred compensation is includible in income only when received by, or unconditionally made available to, a participant. For distributions from an eligible government plan, the deferred compensation is included in gross income only when actually paid. If a plan is not an eligible plan, the present value of the deferred compensation is includible in gross income for the first tax year in which there is no substantial risk of forfeiture, and the tax treatment of any amount made available to a participant is determined under the annuity rules. See ¶ 2193 for further discussion of 457 plans.

Unfunded Plans of Taxable Employers. An unfunded plan of a taxable employer is not subject to limitations similar to those that apply to a tax-exempt employer. As a practical matter, however, such a plan is limited to providing benefits in excess of those permitted under qualified plans or benefits for highly compensated and managerial employees. This is because any other unfunded deferred compensation plan of a taxable employer would be subject to participation, vesting, funding, and fiduciary standards of Employee Retirement Income Security Act of 1974 (ERISA) (P.L. 93-406) (ERISA Secs. 4(b)(5), 201(2), 301(a)(3), and 401(a)(1)). See ¶ 2197 and ¶ 2199 for a discussion of nonqualified deferred compensation plans.

Interest

724. Interest Generally. All interest received or accrued is fully taxable (Reg. § 1.61-7),[56] except interest on tax-exempt state or municipal bonds, including qualified private activity bonds (¶ 729), and interest on U.S. savings bonds used to pay qualified educational expenses (¶ 863). A cash-basis taxpayer is taxed on interest when received. Interest on bank deposits, coupons payable on bonds, etc., is considered available and taxed to a cash-basis taxpayer under the doctrine of constructive receipt and is taxed when credited or due (¶ 1533).

Interest earned on corporate obligations is generally taxed when actually received by, or credited to, a cash-basis taxpayer (Reg. § 1.61-7(a)). The same rule applies to interest on certificates of deposit, time obligations, and similar deposit arrangements on which interest is credited periodically and can be withdrawn without penalty even though the principal cannot be withdrawn without penalty prior to maturity. However, interest on a six-month certificate that is not credited or made available to the holder without penalty before maturity is not includible in the holder's income until the certificate is redeemed or matures (Rev. Rul. 80-157, amplified by Rev. Rul. 82-42).[57]

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[53] ¶ 21,009.1967; COMPEN: 15,202; § 25,610.15

[54] ¶ 21,009.135; COMPEN: 15,202; § 25,610.15

[55] ¶ 21,531; COMPEN: 15,150; § 25,310.10 , § 25,315.05

[56] ¶ 5702; INDIV: 12,052; § 3,101

[57] ¶ 21,009.3247; INDIV: 12,102, INDIV: 12,110.10; § 3,101

Increments in value on growth savings certificates are taxable in the year that the increase occurs because the certificate holder has a present right to redeem the certificate (Rev. Rul. 66-44).[58] Any increment in the value of life insurance or annuity prepaid premiums or premium deposits is income when made available to the policyholder for withdrawal or when credited against premiums payable.[59] Interest on a judgment is taxable even if the underlying award is nontaxable.[60]

When a bond with defaulted interest coupons is bought "flat" (i.e., the price covers both principal and unpaid interest), any interest received that was in default on the date of purchase is not taxable but is a return of capital. If the bond is sold, this amount must be applied to reduce the basis, in turn increasing the gain or reducing the loss. If interest is received for a period which *follows* the date of purchase, it is taxable in full (Reg. § 1.61-7(c)).[61]

Under the accrual method, interest is taxable as it accrues even though it is payable later. An exception to this rule applies when it is discovered before the close of the tax year that the interest owed to the taxpayer will not be collected.[62]

State and Local Bonds; Tax Credit Bonds. The federal government provides financial assistance to state and local governmental agencies by excluding from the gross income of the recipient the interest on certain tax-exempt state and local bonds. Bond interest is not tax free, however, when it is derived from certain state or local bonds that are private activity bonds (¶ 729), bonds that have not been issued in registered form, arbitrage bonds, hedge bonds, or federally guaranteed bonds (Code Secs. 103, 148 and 149).[63]

The federal government also authorizes the issuers of such bonds to issue tax credit bonds. A tax credit bond essentially provides the issuer with a tax-free loan. The bond holders receive a tax credit on their federal income tax at the specified credit rate, instead of interest payments, and the issuer only has to repay the principal. The bond holders must include the credit amount in income, then claim the credit against tax on their return. In effect, the holders will usually receive the same net amount from the credit as they would receive in interest from a conventional state or local bond. See ¶ 1371 for discussion of tax credit bonds.

726. Mortgage Interest. The U.S. Supreme Court held that when a taxpayer forecloses on a mortgage and purchases the property at a foreclosure sale by bidding on the property for the full amount of the mortgage plus accrued unpaid interest, taxable income is realized in the amount of the accrued interest even if the fair market value (FMV) of the property bid on is less than the principal due on the mortgage (*Midland Mutual Life Ins. Co.*, SCt, 37-1 USTC ¶ 9114). Other courts have applied the same rule to *voluntary* conveyances by the mortgagor in consideration for the cancellation of the principal and interest of the mortgage. There is no interest income, however, in the case of such a conveyance if the property is worth less than the principal of the loan.[64] Nor is any taxable income realized if only the principal of the mortgage is bid. For repossessions of real property, see ¶ 1841.

If a creditor bids on a property for a debt, a loss may be deductible if the property is worth less than the debt.[65] Any such loss must take into account the basis and FMV of the property bid on, and therefore a loss may exist even though the creditor bid on the property for more than the debt (*Hadley Falls Trust Co.*, CA-1, 40-1 USTC ¶ 9352).[66] The FMV of the mortgaged property is presumed to be the amount bid in the absence of clear and convincing proof to the contrary (Reg. § 1.166-6). See ¶ 1135 for a discussion of the bad debt deduction, and ¶ 1139 for discussion of secured bad debt.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[58] ¶ 21,009.1142; INDIV: 12,102, INDIV: 12,110.10; § 38,315.15

[59] ¶ 5504.2665; INDIV: 12,118, INDIV: 30,352; § 3,101

[60] ¶ 30,575.166; INDIV: 12,112; § 3,805.35

[61] ¶ 5702, ¶ 5704.3062; INDIV: 12,252.25; § 45,415.15

[62] ¶ 5704.32; INDIV: 12,254; § 3,101

[63] ¶ 6600, ¶ 7870, ¶ 7900; SALES: 51,050; § 3,105

[64] ¶ 5704.338; REAL: 6,154

[65] ¶ 10,750.10; BUSEXP: 48,204

[66] ¶ 10,670.123; BUSEXP: 48,204, REAL: 6,152.10

federal income taxation, except for the tax imposed on unrelated business income (¶ 655 and following) (Code Sec. 529).[76]

Form 990-T. Colleges and universities of states and other governmental units, as well as subsidiary corporations wholly owned by such colleges and universities, are subject to the Form 990-T filing requirements, unless otherwise exempted as a Code Sec. 501(c)(1) corporation.

Contributions. Contributions to a QTP on behalf of any beneficiary cannot exceed the necessary amount of qualified higher education expenses (QHEEs) for the beneficiary. There are no adjusted gross income phaseout limits. In addition, a taxpayer can contribute to both a QTP and a Coverdell account (¶ 867) in the same year for the same beneficiary.

Qualified Higher Education Expenses (QHEEs). For this purpose, QHEEs include tuition, fees, books, supplies, and equipment required by an educational institution for enrollment or attendance. They also include the reasonable cost of room and board if the beneficiary is enrolled at least half-time (Code Sec. 529(e)(3)).[77] Certain expenses of special needs beneficiaries may also be considered QHEEs. The amount of QHEEs must be reduced by the amount of any other tax free benefits, i.e., scholarship or fellowship grants excluded from gross income (¶ 865), or the education credits (¶ 1303).

Distributions. The part of a distribution representing the amount paid or contributed to a QTP is excludable from gross income to the extent that the distribution is used to pay for QHEEs. The designated beneficiary generally does not have to include in income any earnings distributed from a QTP, if the total distribution is less than or equal to adjusted qualified education expenses (Code Sec. 529(c)(3)). Distributions that exceed the beneficiary's qualified higher education expenses are generally taxed under the Code Sec. 72 annuity rules (¶ 817). The part of any distribution from a QTP that represents amounts paid or contributed to the account represent a return of the investment in the account. Distributions of program earnings in excess of the beneficiary's qualified higher education expenses are includable in income and subject to an additional 10-percent tax, i.e., a penalty (Code Sec. 529(c)(6)).[78]

Rollovers and Transfers. Generally, amounts can be rolled over from one qualified tuition program to another for the benefit of the same designated beneficiary, or another beneficiary who is a member of the same family, without tax consequences. In order to qualify for rollover treatment, a distribution from the first QTP must be paid into the second QTP no later than the 60th day after the payment or distribution is made. If the rollover is made to another QTP of the same beneficiary, then only one such transfer is permitted within 12 months of the previous transfer to any QTP for that designated beneficiary (Code Sec. 529(c)(3)).[79]

Estate and Gift Tax Treatment. A contribution to a QTP is treated as a completed gift of a present interest for gift tax purposes (Code Sec. 529(c)(2)). Thus, the contribution qualifies for the annual gift tax exclusion (¶ 2905). If a donor's contribution exceeds the annual exclusion amount, then he or she may elect to take the excess into account ratably over five years. A QTP contribution does not qualify for the unlimited gift tax exclusion for money used to pay educational expenses (¶ 2907). No portion of a contribution is generally includible in the estate of a donor who dies after June 8, 1997, unless the donor dies during the five-year period in which excess contributions to a QTP are being ratably taken into account.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[76] ¶ 22,940; INDIV: 60,204, EXEMPT: 9,950; § 1,805.05
[77] ¶ 22,940; INDIV: 60,206; § 1,805.20
[78] ¶ 22,940; INDIV: 60,204.15; § 1,805.35
[79] ¶ 22,940; INDIV: 60,204.20; § 1,805.45

Other Exclusions from Gross Income

871. Exclusion or Rollover of Certain Stock Gains. Noncorporate taxpayers may exclude from gross income a certain percentage of capital gain from the sale or exchange of qualified small business stock held for more than five years and issued after August 10, 1993 (¶ 1905). Noncorporate taxpayers may also elect to roll over capital gain from the sale of qualified business stock held for more than six months if other qualified small business stock is purchased during the 60-day period beginning on the date of sale (¶ 1907). Individuals and C corporations may elect to defer recognition of capital gain realized upon the sale of publicly traded securities if the sale proceeds are used within 60 days to purchase common stock or a partnership interest in a specialized small business investment company (SSBIC) (¶ 1909).

873. Employee Benefits. Compensation for personal services includes any benefits an employer provides to employee which are not otherwise excludable from income (Reg. § 1.61-2(a)).[80] Excludable employee benefits include:

- amounts received under employer-financed accident and health plans (¶ 2015);
- employer contributions to provide the accident and health benefits (¶ 2013);
- employer contributions to a health savings account (HSA) (¶ 2035), Archer medical savings account (MSA) (¶ 2037), health reimbursement arrangement (HRA) (¶ 2039), or flexible spending arrangement (FSA) (¶ 2041);
- premiums for group-term life insurance to the extent coverage does not exceed $50,000 (¶ 2055);
- qualified adoption expenses reimbursed under an employer adoption assistance program (¶ 2063);
- child and dependent care assistance benefits (¶ 2065);
- educational assistance benefits (¶ 2067);
- employee achievement awards to the extent deductible by the employer (¶ 2069); and
- certain other fringe benefits (¶ 2085).

Some excludable employee benefits may be provided to an employee through the employer's cafeteria plan (¶ 2045).

875. Minister's Home or Rental Allowance. Ministers of the gospel may exclude from gross income the rental value of homes furnished by churches as part of their compensation (Code Sec. 107; Reg. § 1.107-1).[81] This includes the portion of a retired minister's pension designated as a rental allowance by the national governing body of a religious denomination having complete control over the retirement fund.[82] The exemption also applies to the rental value of a residence furnished to a retired minister but not a widow.[83]

A minister is entitled to deduct mortgage interest and real property taxes paid on a personal residence even if the amounts expended are derived from a rental allowance that is excludable from the minister's gross income (Code Sec. 265(a)(6)).[84]

877. Reimbursed Living Expenses. A taxpayer whose principal residence is damaged or destroyed by fire, storm, or other casualty and who must temporarily occupy another residence during the repair can exclude from gross income any insurance payments received as reimbursement for *increased* living expenses during such period. This also applies to a person who is denied access to his principal residence by governmental authorities because of the occurrence or threat of occurrence of a casualty (Code Sec. 123; Reg. § 1.123-1).[85]

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[80] ¶ 5506; COMPEN: 6,050; § 3,005.05
[81] ¶ 6850, ¶ 6851; COMPEN: 6,554; § 3,005.20
[82] ¶ 6852.12; COMPEN: 6,556; § 3,005.20
[83] ¶ 6852.31; COMPEN: 6,556; § 3,005.20
[84] ¶ 14,050; INDIV: 48,554.05; § 46,110.10
[85] ¶ 7300, ¶ 7301; INDIV: 33,450; § 4,005.10

Alternatively, if the real estate taxes are a "recurring item," a taxpayer may elect to accrue the taxes and claim the deduction on the date the tax is assessed or becomes a lien against the property (Code Sec. 461(h)(3); Reg. §1.461-5).[47] Either election may be made without IRS consent for the first tax year in which a taxpayer accrues real property taxes. For later years, the IRS has provided automatic consent procedures for taxpayers to make the elections (Rev. Proc. 2011-14).

Making the Election. Whether a taxpayer should make the election to ratably accrue property taxes or adopt the recurring item exception to the economic performance rule depends on the taxpayer's tax year and lien date of the jurisdiction in which the real property is located. Except where taxes are prepaid, either option is more favorable than the payment rule.

Example 1: X is a calendar-year, accrual-method taxpayer who owns Blackacre in Cook County, Illinois, where the real property tax year is the calendar year and 2014 real property taxes were assessed and became a lien on the property on January 1, 2014. One-half of the taxes are due on March 1, 2015, and the other half on August 1, 2015. Under its three options for accruing real property taxes, X would allocate its deduction between 2014 and 2015 as follows:

- *Payment rule.* 2014: none. 2015: 12/12.
- *Ratable accrual.* 2014: 12/12. 2015: none.
- *Recurring item exception.* 2014: 12/12 (provided that X adopted the recurring item exception on either a timely filed original return or on an amended return filed after paying the second installment but before September 15, 2015). 2015: none.

Example 2: Assume X owns Greenacre in Alabama, where taxes for the fiscal year from October 1, 2014, to September 30, 2015, were assessed and became a lien on the property on October 1, 2014. Taxes are due on October 1, 2015. Under its three options for accruing real property taxes, X would allocate its deduction between 2014 and 2015 as follows:

- *Payment rule.* 2014: none. 2015: 12/12.
- *Ratable accrual.* 2014: 3/12. 2015: 9/12.
- *Recurring item exception.* 2014: none (because taxes are not due until more than 8½ months after end of 2014). 2015: 12/12. However, X could advance its entire deduction into 2014 by prepaying its real property taxes on or before September 15, 2015.

1032. Apportionment of Real Property Tax Upon Sale. The real property tax deduction must be apportioned between the seller and the buyer according to the number of days in the real property tax year that each holds the property (¶ 1033). When property is sold during any real property tax year, the taxes are imposed upon the seller up to, but not including, the date of sale. The taxes are imposed on the buyer beginning with the date of sale. Proration is required whether or not the seller and purchaser actually apportion the tax (Reg. §1.164-6(a) and (b)(1)).[48] When property is sold, however, before or after the real property tax year, see ¶ 1038.

Example 1: A sells his farm to B on August 1, 2014. Both use the cash- and calendar-year basis of accounting. Taxes for the real property tax year, April 1, 2014, to March 31, 2015, become due and payable on May 15, 2015. B pays the real estate taxes when they fall due. Regardless of any agreement between the parties, for federal income tax purposes 122/365 of the real estate taxes are treated as imposed upon A and are deductible by him.

Example 2: Assume the same facts as in Example 1 above, except that A uses the accrual basis of accounting. If A has not elected to accrue the real property taxes ratably, he will be treated as having accrued 122/365 of the taxes on the date of sale. The balance is deductible by B when she pays the taxes, if she is on the cash basis, unless the rule at ¶ 1035 applies because the seller (A) is personally liable for the taxes. If B is on the accrual basis, she follows the rules explained at ¶ 1031.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[47] ¶ 21,802, ¶ 21,811; ACCTNG: 12,104.10; §38,435.10

[48] ¶ 9603; INDIV: 45,300; §7,315.10

1033. Real Property Tax Year Defined. The real property tax year is the period to which the tax relates under state law, local law, or the law imposing the tax. If a state and one or more local governmental units each imposes a tax, the real property tax year for each tax must be determined (Reg. §1.164-6(c)).[49]

1034. Cash-Basis Sellers. The portion of the real estate tax imposed on a cash-basis seller under the rules described at ¶ 1032 may be deducted by the seller in the tax year of the sale, whether or not actually paid in that tax year, if: (1) the buyer is liable for the real estate tax for the real property tax year; or (2) the seller is liable for the real estate tax for the real property tax year and the tax is not payable until after the date of sale. When the tax is not a liability of any person, the person who holds the property at the time the tax becomes a lien on the property is considered liable for the tax (Reg. §1.164-6(d)(1) and (3)).[50]

1035. Cash-Basis Buyers. The portion of the real estate tax imposed on a cash-basis buyer under the rules described at ¶ 1032 may be deducted by the buyer in the tax year of the sale, whether or not the tax is actually paid by the buyer in the tax year of the sale, if the seller is liable for the real estate tax. When the tax is not a liability of any person, the person who holds the property at the time the tax becomes a lien on the property is considered liable for the tax (Reg. §1.164-6(d)(2) and (3)).[51]

1036. Accrual-Basis Buyers and Sellers. For accrual-basis buyers or sellers who do not elect ratable accrual for property taxes (¶ 1031), the portion of their tax liability (¶ 1032) that may not be deducted for any tax year by reason of their accounting method is treated as if accrued on the date of sale (Reg. §1.164-6(d)(6)).[52]

1037. Excess Deduction. If a taxpayer deducted real estate taxes in excess of the portion of such tax treated as imposed upon the taxpayer under the rules discussed at ¶ 1032 in a tax year before the year of sale, the excess amount is included in the taxpayer's gross income in the year of sale, subject to the tax benefit rule (¶ 799) (Reg. §1.164-6(d)(5)).[53]

Example: A is a cash-basis taxpayer whose real property tax is due and payable on November 30 for the next calendar year, which is also the real property tax year. A paid the 2014 real property taxes on November 30, 2013, and deducted them on his 2013 income tax return. On June 30, 2014, A sold the real property. Only the taxes from January 1 through June 29, 2014, i.e., the 179/365 portion, are treated as imposed on A. The excess amount deducted by A on his 2013 income tax return is includible in his gross income in 2014.

1038. Property Sold Before or After Real Property Tax Year. If property is sold after the real property tax becomes a personal liability or a lien but before the beginning of the related real property tax year (¶ 1033), the seller may not deduct any amount for real property taxes for the related real property tax year. To the extent that the buyer holds the property for that real property tax year, the buyer may deduct the amount of the taxes for the tax year in which they are paid or accrued. Conversely, where the property is sold before the tax becomes a personal liability or a lien but after the end of the related real property tax year, the buyer cannot deduct any amount for taxes for the related real property tax year. To the extent that the seller holds the property for that real property tax year, the seller may deduct the amount of the taxes for the tax year they are paid or accrued (Reg. §1.164-6(b)(1)(ii) and (iii)).[54]

1040. Cooperative Housing Corporation. A tenant-stockholder may deduct amounts paid or accrued to the cooperative housing corporation (CHC) to the extent that they represent the tenant's proportionate share of: (1) real estate taxes on the apartment building or houses and the land on which they are situated; or (2) interest on debt contracted in the acquisition, construction, alteration, rehabilitation, or mainte-

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[49] ¶ 9603; INDIV: 45,312; §7,315.10b

[50] ¶ 9603; INDIV: 45,316; §7,315.10

[51] ¶ 9603; INDIV: 45,316; §7,315.10

[52] ¶ 9603; INDIV: 45,318; §7,315.10

[53] ¶ 9603; INDIV: 45,318; §4,210, §7,315.10

[54] ¶ 9603; INDIV: 45,308, INDIV: 45,310; §7,315.10c

purpose, AGI is computed without regard to: taxable Social Security and railroad retirement benefits; the exclusion for qualified U.S. savings bonds used to pay higher education expenses; the exclusion for employer adoption assistance payments; passive activity income or loss included on Form 8582; any overall loss from a publicly traded partnership; rental real estate losses allowed to real estate professionals; the domestic production activities deduction; and deductions for contributions to IRAs and pension plans, for one-half of self-employment tax, interest on student loans, and higher education expenses.

Separate Returns. For married taxpayers who file separate returns and live apart, up to $12,500 of passive losses may be used to offset nonpassive income. This amount is reduced by 50 percent of the amount by which the taxpayer's modified AGI exceeds $50,000. The special allowance is completely phased out when modified AGI reaches $75,000. Married taxpayers who file separately and live together at any time during the tax year are not eligible for the special allowance (Code Sec. 469(i)(5)).

Offset of Credits. Passive activity credits attributable to rental real estate activities in which the taxpayer actively participates may be claimed under the $25,000 offset provision, but only after all eligible losses have been used. Special rules apply for the phaseout of the rehabilitation credit (¶ 1365B), low-income housing credit (¶ 1365K), and commercial revitalization deduction (Code Sec. 1400I).

1185. Real Estate Professionals. Real estate professionals may be able to treat rental real estate activities as nonpassive and thus not subject to the passive activity rules (¶ 1165) (Code Sec. 469(c)(7); Reg. § 1.469-9(g)).[120] To qualify:

- more than one-half of the personal services performed in trades or businesses by the taxpayer during the tax year must involve real property trades or businesses in which the taxpayer or the taxpayer's spouse materially participates; and
- the taxpayer must perform more than 750 hours of service during the tax year in real property trades or businesses in which the taxpayer or the taxpayer's spouse materially participates (¶ 1165).

These two requirements must be satisfied by one spouse if a joint return is filed. Personal services performed as an employee are not taken into account under either requirement unless the employee owns more than a five-percent interest in the employer. A real property trade or business is a business with respect to which real property is developed or redeveloped, constructed or reconstructed, acquired, converted, rented or leased, operated or managed, or brokered.

The exception for real estate professionals is applied as if each interest of the taxpayer in rental real estate is a separate activity. However, a taxpayer may elect to treat all interests in rental real estate as a single activity for purposes of satisfying the material participation requirements. To make the election, the taxpayer must file a statement with the taxpayer's original income tax return for the tax year declaring that he or she is a qualified taxpayer for the tax year and is making the election. Certain taxpayers may be permitted to make late elections (Rev. Proc. 2011-34).[121]

A closely held corporation qualifies as a real estate professional if more than 50 percent of its annual gross receipts for the tax year are from real property trades or businesses in which it materially participates.

Tax-Exempt Use Property

1191. Limits on Tax-Exempt Use Losses. A taxpayer leasing property to a government or other tax-exempt entity (i.e., sale-in, lease-out (SILO) arrangement) is not allowed to claim deductions that are related to the property (known as tax-exempt use property) to the extent that they exceed the taxpayer's income from the lease payments

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[120] ¶ 21,960, ¶ 21,965D; BUSEXP: 33,106.40; § 17,430.15

[121] ¶ 21,966.568; BUSEXP: 33,106.40; § 17,430.15

(a tax-exempt use loss), subject to certain exceptions (Code Sec. 470).[122] Tax-exempt use property includes property owned by a partnership or other pass-through entity that has at least one tax-exempt partner and the allocations of partnership items attempt to inappropriately transfer the deductions from the tax-exempt partner to the taxable partners (Code Sec. 168(h)).[123]

Tax-exempt losses disallowed may be carried over to the next tax year and can be deducted to the extent of the taxpayer's net income from the property for that year. If property ceases to be tax-exempt use property during the lease term, the carried-over loss cannot be used to offset income from other property. If the property is disposed of, any disallowed loss is available under rules similar to passive activity losses (¶ 1177). However, the limitation on tax-exempt use property losses is applied before the passive activity rules (¶ 1169).

Hobby Losses

1195. Hobby Expenses and Losses. Expenses incurred by individuals, S corporations, partnerships, estates, and trusts that are attributable to an activity not engaged in for profit, i.e., a hobby, are generally deductible only to the extent of income produced by the activity (Code Sec. 183; Reg. § 1.183-1).[124] Specifically, if any activity is not engaged in for profit, deductions are allowed as follows:

(1) deductions a taxpayer can claim whether or not they are incurred with a hobby, e.g., taxes, interest, and casualty losses, are allowed even if they exceed hobby income;

(2) deductions that do not result in an adjustment to the basis of property, e.g., operating expenses, supplies, are allowed, but only to the extent that gross income from the hobby exceeds the deductions under category (1); and

(3) deductions that result in an adjustment to the basis of property, e.g., depreciation, amortization, are allowed, but only to the extent that gross income from the hobby that exceeds the deductions under category (1) and (2).

Individuals must claim the deductions in categories (2) and (3) above as miscellaneous itemized deductions on Schedule A of Form 1040, subject to the two-percent-of-adjusted-gross-income limitation (¶ 1011). If a partnership or S corporation carries on a hobby, the deduction limits apply at the entity level and are reflected in the individual shareholder's or partner's distributive shares.

Whether an activity is engaged in for profit is generally determined based on the facts and circumstances. However, an activity is presumed not to be a hobby if it produced a profit (gross income exceeded deductions) in any three of five consecutive tax years ending with the tax year in question, unless the IRS proves otherwise. An activity involving the breeding, training, showing, or racing of horses is presumed not to be a hobby if it produced a profit in two out of seven consecutive tax years. A special election on Form 5213 permits suspension of the presumption until after the fourth (or sixth, for horse breeding, training, showing, or racing) tax year after which the taxpayer first engages in the activity. Filing Form 5213 automatically extends the statute of limitations for the IRS to assess a deficiency for any deductions of the activity in any year in the five-year or seven-year period to two years after the due date of the return for the last year of the period.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[122] ¶ 21,970; BUSEXP: 36,000

[123] ¶ 11,250; BUSEXP: 36,050

[124] ¶ 12,170, ¶ 12,171; BUSEXP:15,000; § 17,201

year of the partner(s) owning in total more than a 50-percent interest in partnership profits and capital (¶ 416). If there is no majority interest tax year, the partnership must adopt the same tax year as that of its principal partners, each of whom must have at least a 5-percent interest in partnership profits or capital. When neither condition is met, the partnership must use the tax year that produces the least aggregate deferral of income to the partners.

Corporations. An S corporation or a personal service corporation (PSC) (¶ 273) must generally use the calendar year unless the entity can establish a business purpose for having a different tax year (Code Secs. 441(i) and 1378(b)).[6] The ownership tax year of an S corporation generally satisfies the business purpose requirement. A corporation is not considered a PSC unless more than 10 percent of its stock, by value, is held by employee-owners. If a corporation is a member of an affiliated group filing a consolidated return, all members of that group must be considered in determining whether the corporation is a PSC.

Section 444 Election of Nonrequired Year. A partnership, S corporation, or PSC may make a section 444 election on Form 8716 to use a tax year other than a required tax year if the deferral period of the elected year is generally not longer than three months (Code Sec. 444).[7] To neutralize the tax benefits resulting from such a tax year, an electing partnership or S corporation must compute and make any required payments, i.e., the amount of tax that would otherwise be due from partners and stockholders had the entity used the required tax year, exceeding $500 (Code Sec. 7519; Temp. Reg. § 1.7519-2T).[8] The required payment is due on or before May 15 of the calendar year following the calendar year in which the election year begins. An electing PSC must make minimum distributions to its employee-owners by the end of a calendar year falling within a tax year to avoid certain deduction deferrals for amounts paid to employee-owners (Code Sec. 280H).[9]

The section 444 election must be made by the earlier of: (1) the 15th day of the fifth month following the month that includes the first day of the tax year for which the election is first effective, or (2) the due date, without extensions, of the return that results from the election (Code Sec. 444(d); Temp. Reg. § 1.444-3T).[10] The election remains in effect until an entity changes its tax year or otherwise terminates such an election. The election may not be made by an entity that is a member of a tiered structure unless the tiered structure consists only of partnerships or S corporations or both, all of which have the same tax year.

Common Trust Funds. Common trust funds, certain investment funds maintained by a bank (¶ 2389), are required to adopt the calendar year as their tax year (Code Sec. 584(i)).[11]

DISCs. The tax year of a domestic international sales corporation (DISC) (¶ 2498) must be the same as that of the shareholder or group of shareholders with the same tax year who have the highest percentage of voting power. Voting power is determined on the basis of total combined voting power of all classes of stock of the corporation entitled to vote. If two or more shareholders or groups are tied for the highest percentage, the tax year used is that of any such shareholder or group (Code Sec. 441(h)).[12]

1503. 52- or 53-Week Accounting Period. A taxpayer may elect to use a fiscal tax year that varies from 52 to 53 weeks if that period always ends on the same day of the week (Monday, Tuesday, etc.) and that day is either the last such day in a calendar month or the closest such day to the last day of a calendar month (Code Sec. 441(f); Reg. § 1.441-2).[13]

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[6] ¶ 20,302, ¶ 32,260; ACCTNG: 24,354, ACCTNG: 24,356; § 27,120, § 28,410.15
[7] ¶ 20,600; ACCTNG: 24,450; § 38,115.05
[8] ¶ 42,770, ¶ 42,773; ACCTNG: 24,500; § 38,115.10
[9] ¶ 15,160; ACCTNG: 24,550; § 38,115.15
[10] ¶ 20,600, ¶ 20,604; ACCTNG: 24,450; § 38,115.05
[11] ¶ 23,630; RIC: 12,304.15
[12] ¶ 20,302; ACCTNG: 24,110.10
[13] ¶ 20,302, ¶ 20,304; ACCTNG: 24,302; § 38,105

Example: A new taxpayer wishes to have its accounting period end on the last Monday in August. In 2014, its tax year ends on August 25, completing a 52-week year (August 27, 2013, through August 25, 2014). In 2015, its tax year ends on August 31, completing a 53-week year (August 26, 2014, through August 31, 2015). With this type of tax year, most of the taxpayer's tax years are 52 weeks long. As an alternative, the taxpayer could select a tax year that ends on the Monday that is nearest to the end of August. In 2014, therefore, the tax year ends on September 1 (the Monday nearest the end of August). In 2015, the tax year ends on August 31.

If a pass-through entity or an owner of a pass-through entity, or both, use a 52-53-week tax year and the tax year of the entity and owner end with reference to the same calendar month, then for purposes of determining the tax year in which items of income, gain, loss, deductions, or credits from the entity are taken into account by the owner, the owner's tax year will be deemed to end on the last day of the entity's tax year. Under this rule, a pass-through entity is a partnership, S corporation, trust, estate, closely held real estate investment trust (¶ 2326), common trust fund (¶ 2389), controlled foreign corporation (¶ 2487), or passive foreign investment company (¶ 2490) (Reg. § 1.441-2(e)).[14]

1505. Short-Period Return. A return for a period of less than 12 months may need to be filed by a taxpayer who changes its annual accounting period (¶ 1513) or is in existence during only part of what would otherwise be the tax year (Code Sec. 443; Reg. § 1.443-1).[15]

Taxpayers who are not in existence for a full 12-month period include:

(1) a corporation that begins business or goes out of business at any time other than the beginning or end of its accounting period,

(2) an individual taxpayer who dies prior to the end of the accounting period, and

(3) a decedent's estate that comes into existence on the date of the decedent's death and adopts an accounting period ending less than 12 months from that date.

If the taxpayer is not in existence for a full tax year, the tax is computed as if the return had actually covered a full tax year. When a short period occurs as a result of a change in accounting period, the tax is computed on an annualized basis (¶ 1507). An alternative relief method is also available for taxpayers that change their accounting period (¶ 1509). Short-period returns of decedents and dissolving corporations, and the first return of a new corporation, however, are not required to be annualized.

If a change to or from a 52-53 week tax year results in a short period of 359 days or more, the tax is computed as if the return had actually covered a full tax year. If the short period is less than seven days, the short period becomes a part of the following tax year. If the short period is more than six days but less than 359 days, the tax is computed under the annualized method (Code Sec. 441(f)(2)).[16] Special annualization rules apply to taxpayers that make such a change (¶ 1507).

1507. General Method for Annualizing Income for Short Periods. When there has been a change in an accounting period that necessitates the filing of a short-period return (¶ 1505), income for the period must be converted to an annual basis. This conversion is generally accomplished by: (1) multiplying the taxpayer's modified taxable income for the short period by 12 and (2) dividing the result by the number of months in the short period. The tax is computed on the resulting taxable income except that individuals must use the tax rate schedules to compute the tax and not the tax tables. The tax so computed is divided by 12 and multiplied by the number of months in the

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[14] ¶ 20,304; ACCTNG: 24,308; § 38,105
[15] ¶ 20,500, ¶ 20,501; ACCTNG: 24,250; § 38,140.05
[16] ¶ 20,302; ACCTNG: 24,306; § 38,140.15

— a timeshare right to use or own residential real property for not more than six weeks per year, or a right to use specified campgrounds for recreational purposes.

A timeshare right to use or own property held by an individual's spouse, children, grandchildren, or parents is treated as held by the individual.

Payment of Interest. To use the installment method for the sale of residential lots and timeshares, the taxpayer must pay interest on the amount of tax attributable to the installment payments received during the year. The interest is calculated for the period beginning on the date of sale and ending on the date the payment is received (Code Sec. 453(l)(3)).[7] The amount of interest is based upon the applicable federal rate in effect at the time of sale, compounded semiannually (¶ 1875).

Computation of Income

1813. Amount of Income for Installment Sales. For nondealer dispositions of property (¶ 1808) that are not subject to the depreciation recapture provisions of Code Sec. 1245 or Code Sec. 1250, the amount of income reported from an installment sale in any tax year (including the year of sale) is equal to the payments received during the year multiplied by the gross profit ratio for the sale (Code Sec. 453(c); Temp. Reg. § 15A.453-1(b)(2)).[8] Payments include all amounts actually or constructively received in the tax year under the installment obligation (¶ 1819).

The gross profit ratio is the gross profit on the installment sale divided by the total contract price. The gross profit is the selling price of the property minus its adjusted basis. The selling price of the property is not reduced by any existing mortgage or encumbrance, or by any selling expenses, but is reduced by any imputed interest (¶ 1859).

The total contract price (denominator of gross profit ratio) is the selling price minus that portion of qualifying indebtedness (¶ 1815) which the buyer assumes or takes the property subject to that does not exceed the seller's basis in the property (adjusted to reflect commissions and other selling expenses). In the case of an installment sale that is a partially nontaxable like-kind exchange (¶ 1723), the gross profit is reduced by that portion of the gain that is not recognized, and the total contract price is reduced by the value of the like-kind property received (Code Sec. 453(f)(6)).[9]

For certain nondealer sales of property over $150,000, a special interest charge may apply (¶ 1825).

1815. Qualifying Indebtedness for Installment Sales. For the purpose of determining the total contract price of an installment sale of property (¶ 1813), qualifying indebtedness includes:

(1) any mortgage or other indebtedness encumbering the property; and

(2) any indebtedness not secured by the property but incurred or assumed by the purchaser incident to the acquisition, holding or operation of the property in the ordinary course of business or investment (Temp. Reg. § 15A.453-1(b)(2)(iv)).[10]

Qualifying indebtedness does not include an obligation of the seller incurred incident to the *disposition* of the property, or an obligation functionally unrelated to the acquisition, holding or operation of the property. Any obligation incurred or assumed in contemplation of disposition of the property is not qualifying indebtedness if recovery of the seller's basis is accelerated.

Wrap-Around Mortgage. When property encumbered by an outstanding mortgage is sold in exchange for an installment obligation equal to the mortgage, the installment

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[7] ¶ 21,402; SALES: 36,054.10; § 18,310.10
[8] ¶ 21,402, ¶ 21,404; SALES: 36,100; § 18,320
[9] ¶ 21,402; SALES: 36,114.05; § 18,350
[10] ¶ 21,404; SALES: 36,106; § 18,320

obligation is said to "wrap around" the mortgage. The seller generally uses the payments received from the installment obligation to pay the "wrapped" mortgage. In this situation, the IRS will follow the Tax Court's position and will not treat the buyer as having taken the property subject to, or as having assumed, the seller's mortgage (*Professional Equities, Inc.*, 89 TC 165, Dec. 44,064 (1987) (Acq.)).[11] As a result, the seller does not have to reduce the total contract price by the amount of the wrapped mortgage.

1819. Installment Payments. When determining the amount of reportable income under the installment method (¶ 1813), a payment includes all amounts actually or constructively received in the tax year under an installment obligation, as well as:

(1) evidence of indebtedness of a person other than the buyer;

(2) evidence of indebtedness of the buyer that is payable on demand or readily tradable, including a bond issued with coupons or in registered form;

(3) a bank certificate or treasury note;

(4) qualifying indebtedness (¶ 1815) assumed or taken subject to by the buyer, to the extent it exceeds the seller's basis for the sold property as adjusted for selling expenses;

(5) seller's indebtedness to the buyer that is canceled; and

(6) indebtedness on the sold property (for which the seller is not personally liable) when the buyer is the obligee of the indebtedness (Code Sec. 453(f)(3), (f)(4), and (f)(5); Temp. Reg. § 15A.453-1(b)(3)).[12]

Debt instruments in registered form that the seller can establish are not readily tradable are not considered payments. In addition, like-kind property received in a partially tax-free exchange (¶ 1723) that is part of an installment sale transaction is not treated as a payment for purposes of determining the amount of income to be reported under the installment method (Code Sec. 453(f)(6)).[13]

1821. Contingent Payment Sales. A contingent payment sale must be reported on the installment method (¶ 1801) unless the seller elects not to use the installment method (Temp. Reg. § 15A.453-1(c)).[14] A contingent payment sale is a sale or other disposition of property in which the total selling price is not determinable by the close of the tax year in which the sale or disposition occurs. It does not include transactions with respect to which the installment obligation represents, under applicable principles of tax law: (1) a retained interest in the property which is the subject of the transaction; (2) an interest in a joint venture or partnership; (3) an equity interest in a corporation; (4) or similar transaction, regardless of the existence of a stated maximum selling price or a fixed payment term.

In a contingent payment sale, the basis of the property sold (including selling expenses, but not those of real estate dealers) is allocated to payments received in each tax year and recovered as follows:

- for sales with a stated maximum selling price, basis is recovered according to a profit ratio based on the stated maximum selling price;
- for sales with a fixed payment period, basis is recovered ratably over the fixed period; and
- for sales with neither a maximum selling price nor a fixed payment period, basis is recovered ratably over a 15-year period.

Alternate methods of basis recovery may be required when the normal method would substantially and inappropriately accelerate or defer the recovery of basis.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[11] ¶ 21,412.80; SALES: 36,106; § 18,320
[12] ¶ 21,402, ¶ 21,404; SALES: 36,102; § 18,325
[13] ¶ 21,402; SALES: 36,114.05; § 18,350
[14] ¶ 21,404; SALES: 36,112; § 18,330.05

the federal government, are available in every state beginning January 1, 2014. These exchanges, or marketplaces, provide qualified individuals and small businesses with access to health plans, possibly at subsidized prices. Qualified health plans offered through such an exchange cannot be provided by employers through a cafeteria plan unless the employer is exchange-eligible (Code Sec. 125(f)(3)). An exchange-eligible employer is a small employer electing to make all of its full-time employees eligible for one or more qualified health plans offered in the small group market through an exchange (Act Sec. 1312(f)(2)(A) of the Patient Protection and Affordable Care Act (P.L. 111-148)). A small employer is an employer who employed an average of at least one, but not more that 100, employees on business days during the preceding plan year and employs at least one employee on the first day of the current plan year (Act Sec. 1304(b)(2) of P.L. 111-148). The small group market is the health insurance market under which employees obtain health insurance coverage through a group health plan maintained by a small employer (Act Sec. 1304(a)(3) of P.L. 111-148). Beginning in 2017, the definition of an exchange-eligible employer is expanded to include large employers in addition to small employers (Act Sec. 1312(f)(2)(B) of P.L. 111-148).

2047. Simple Cafeteria Plans. Certain small employers can establish simple cafeteria plans under which the nondiscrimination requirements applicable to regular cafeteria plans (¶ 2045), as well as the nondiscrimination rules applicable to group-term life insurance (¶ 2055), accident and health plans (¶ 2015), and dependent care assistance programs (¶ 2065), are considered satisfied (Code Sec. 125(j)).[53] A simple cafeteria plan is a cafeteria plan established and maintained by an eligible employer that meets certain contribution, eligibility, and participation requirements.

Eligible Employers. To be eligible to establish a simple cafeteria plan, an employer must have employed an average 100 or fewer employers on business days during either of the two preceding years. An employer that was not in existence throughout the preceding year may be considered as an eligible employer if it reasonably expects to average 100 or fewer employees on business days during the current year. If an employer has 100 or fewer employees for the year and establishes a simple cafeteria plan, then it is treated as an eligible employer for any subsequent year even if the employer employs more than 100 employees in the subsequent year, unless the employer employs an average of 200 or more employees during the subsequent year.

For purposes of determining the qualification of a business that has recently changed ownership, the fact that the previous owner had 100 or fewer employees in a preceding year is used to determine eligibility of the current ownership to establish a simple cafeteria plan. Also, any person treated as a single employer for purposes of the work opportunity credit (¶ 1365G) or for purposes of deferred compensation rules for leased employees under Code Sec. 414(n) or Code Sec. 414(o) are treated as one person for purposes of simple cafeteria plans.

Contribution Requirements. The contribution requirements of a simple cafeteria plan are met if the employer is required by the plan to make a contribution to provide qualified benefits on behalf of each qualified employee in an amount equal to: (1) a uniform percentage of at least two percent of the employee's compensation for the year; or (2) at least six percent of the employee's compensation for the plan year or twice the amount of the salary reduction contributions of each qualified employee, whichever is less (Code Sec. 125(j)(3)). If the employer bases the satisfaction of the contribution requirements on the second option, it will not be treated as met if the rate of contributions with respect to any salary reduction contribution of a highly compensated or key employee is greater than that with respect to any other employee.

Employee Eligibility and Participation Requirements. The minimum eligibility and participation requirements of a simple cafeteria plan are met if all employees who had at least 1,000 hours of service for the preceding plan year are eligible to participate. In addition, each employee eligible to participate may elect any benefit under the plan, subject to terms and conditions applicable to all participants (Code Sec. 125(j)(4)). An

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[53] ¶ 7320; COMPEN: 51,250; § 20,840.05

employer may elect to exclude from the plan, regardless of the satisfaction of the 1,000 hour requirement, employees: (1) who have not attained the age of 21 before the close of the plan year; (2) who have less than one year of service with the employer; (3) who are covered under a collective bargaining agreement; or (4) who are nonresident aliens working outside the United States whose income did not come from a U.S. source.

Other Employee Benefits

2055. Group-Term Life Insurance. An employee may exclude from gross income the cost of the first $50,000 of group-term life insurance on the employee's life provided under a policy carried directly or indirectly by the employer (Code Sec. 79(a) and (c); Reg. §§ 1.79-1 and 1.79-3).[54] The cost of coverage in excess of $50,000 is included in the employee's gross income and subject to employment taxes, reduced by any amount the employee paid toward the insurance. The cost in excess of $50,000 is not the employer's actual cost in providing coverage. Instead, the cost is determined under a Uniform Premium Table (see below) which provides a per-month premium cost for $1,000 of insurance based on the employee's age as of the end of the employee's tax year. The $50,000 limit relates to the group-term life insurance coverage which the employee receives during any part of the tax year.

In the case of certain disabled or retired employees, the full cost of employer-provided group-term life insurance coverage is excluded from the employee's income (Code Sec. 79(b) and (d); Reg. § 1.79-2; Temp. Reg. § 1.79-4T).[55] A full exclusion is also available if the employer or a charity is the beneficiary of the insurance benefits. On the other hand, key employees must include the cost of all benefits they receive under plans that do not satisfy nondiscrimination requirements. In addition, coverage on the life of the employee's spouse or dependents is not excluded unless it qualifies as a de minimis fringe benefit (¶ 2089).

Group-term life insurance is insurance that provides for a general death benefit that is excluded from gross income (¶ 803) and provided to a group of at least 10 full-time employees at some time during the year (Reg. § 1.79-1; IRS Pub. 15-B). An employee includes any current common-law employee, former employee, or leased employee, as well as a statutory employee who is a full-time salesperson. An employee does not include a self-employed person, partner, or 2-percent S corporation shareholders. The amount of insurance provided to each employee must be computed under a formula that precludes individual selection. In addition, the policy must not provide any permanent benefits.

Table 1

Cost Per $1,000 of Protection for One-Month Period

Age	*Cost*
Under 25	5 cents
25 through 29	6 cents
30 through 34	8 cents
35 through 39	9 cents
40 through 44	10 cents
45 through 49	15 cents
50 through 54	23 cents
55 through 59	43 cents
60 through 64	66 cents
65 through 69	$1.27
70 and above	$2.06

Example: X Corp. pays the premiums on a $70,000 group-term insurance policy on the life of its president, Fox, who is 51 years old at the end of 2014. The IRS-established uniform cost for $1,000 of group-term coverage for twelve months is $2.76 ($0.23 × 12) (Reg. § 1.79-3(d)(2)). The cost of the policy includible in Fox's gross income is computed as follows:

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[54] ¶ 6360, ¶ 6362, ¶ 6364; COMPEN: 48,100; § 21,005.05

[55] ¶ 6360, ¶ 6363, ¶ 6366; COMPEN: 48,100; § 21,005.05

2217. Substantially All Requirement in C Reorganizations. What constitutes "substantially all" of the properties of a corporation for purposes of a C reorganization (¶ 2209) is not precisely defined in the Code or regulations. However, a special rule provides that a reorganization may still qualify as a C corporation if the acquiring corporation acquires at least 80 percent of all of the target corporation's property solely for voting stock of the acquiring corporation or its parent (Code Sec. 368(a)(1)(C) and (a)(2)(B)).[25] Some courts have held that a transfer of approximately two-thirds in value of the assets, or 68 percent or even 75 percent of all the corporate property, is not "substantially all." Other courts have held that 85.2 percent or even 90 percent, which included all property except cash, was substantially all. The IRS interprets the substantially all requirement, for the purpose of issuing ruling letters, as requiring a transfer of assets representing at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the corporation's gross assets held immediately before the transfer (Rev. Proc. 77-37).[26]

2221. Party to a Reorganization—Plan of Reorganization. The reorganization provisions provide for the nonrecognition solely of the gains and losses of the parties to reorganizations and their shareholders and security holders (¶ 2205 and ¶ 2229). A party to a organization includes a corporation resulting from a reorganization and both corporations in a reorganization resulting from the acquisition by one corporation of stock or properties of another (Code Sec. 368(b); Reg. § 1.368-2(f)).[27] In an A, B, C, or G reorganization (¶ 2209), a party to a reorganization includes a controlling corporation if its stock is exchanged and likewise includes a controlled subsidiary that receives any of the assets or stock exchanged.

A plan of reorganization is required in connection with a tax-free exchange (Reg. § 1.368-2(g)).[28] The plan does not need to be a formal written document. However, the safest practice would be to incorporate the plan into the corporate records. The plan may be amended as circumstances change so long as the reorganization remains in compliance with the reorganization requirements (¶ 2209).

2225. Recapitalization. For a transaction to qualify as a recapitalization or E reorganization (¶ 2209), there must be a reshuffling of the capital structure of a corporation (*Southwest Consolidated Corp.*, SCt, 42-1 USTC ¶ 9248).[29] For example, an E reorganization occurs when a corporation discharges outstanding bond indebtedness by issuing preferred stock to the shareholders in exchange for the bonds instead of paying them off in cash, when 25 percent of a corporation's preferred stock is surrendered for cancellation and no-par-value common stock is issued, or when previously authorized but unissued preferred stock is issued in exchange for outstanding common stock (Reg. § 1.368-2(e)).[30]

2229. Receipt of Stock, Securities or Other Property. No gain or loss is generally recognized by a shareholder or securities holder if stock or securities in a corporation that is party to a reorganization (¶ 2221) are exchanged solely for stock or securities of another corporation, and the exchange is made pursuant to a plan of reorganization (¶ 2209) or a corporate division (¶ 2201) (Code Sec. 354).[31] An exchange of securities in a reorganization is tax free only to the extent that the principal amount received does not exceed the principal amount surrendered. Nonrecognition treatment also does not apply if securities are received and no securities are surrendered. The term "securities" is not defined by the Code or regulations for this purpose. Under case law, however, an instrument with a term of less than five years generally is not a security.[32]

If a shareholder or security holder receives money or other property ("boot") in the exchange, it can result in gain recognition, dividend treatment (¶ 2237), or in the case of a corporate division, treatment as a corporate distribution (Code Sec. 356).[33] Securities

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[25] ¶ 16,750; REORG: 15,056
[26] ¶ 16,753.53; REORG: 15,056
[27] ¶ 16,750, ¶ 16,752; CCORP: 39,054
[28] ¶ 16,752; CCORP: 39,056, REORG: 3,200
[29] ¶ 16,753.476; REORG: 24,050
[30] ¶ 16,752; REORG: 24,052
[31] ¶ 16,431; CCORP: 39,250
[32] ¶ 16,433.61; CCORP: 39,252.05
[33] ¶ 16,490; CCORP: 39,254

received in a Code Sec. 351 exchange are treated as boot for this purpose (¶ 1731). In addition, nonqualified preferred stock is treated as boot (Code Sec. 351(g)).[34] Any liabilities of the shareholder or security holder assumed by a party to the organization are not considered boot (¶ 2233).

If no boot is received in a corporate reorganization or division, the shareholders or security holders retain for the stock or securities they receive the same basis that they had in the stock or securities they surrendered in the exchange (Code Sec. 358).[35] If boot is received, the basis of the nonrecognition property received by a shareholder or security holder is equal to the basis of the stock or securities exchanged in the reorganization, adjusted for the amount of gain or loss recognized, any amount treated as a dividend (¶ 2237), and the amount of the boot received. The basis determined for nonrecognition stock and securities must be allocated among all classes of stock or securities involved in the transaction. The basis of any boot is its fair market value.

2233. Assumption of Liabilities in Reorganizations. A release from liabilities assumed by a transferee or a disposition of property subject to liabilities in a reorganization (¶ 2209), a transfer of property to a controlled corporation (¶ 1731), or certain bankruptcy reorganizations or foreclosures (¶ 2247) is not money or other property ("boot") received by the taxpayer and does not prevent the transaction from being tax free (Code Sec. 357).[36] However, if the principal purpose of the assumption of liabilities is to avoid income tax, or the purpose is not a bona fide business purpose, the liability assumed is treated as boot (unless the taxpayer can prove to the contrary).

If the liabilities assumed, or to which the property is subject, exceed the total basis of all the properties transferred in a Code Sec. 351 exchange or divisive D reorganization involving a corporate division, the excess is treated as gain from a sale or exchange of a capital asset or a noncapital asset, depending on the nature of the encumbered asset transferred (Code Sec. 357(c)). See ¶ 1669 for a discussion of the basis of property after an assumption of liabilities. A liability is excluded from this exception if it is assumed in a Code Sec. 351 transfer and the payment of the liability by the transferor would give rise to a deduction or would be basically the equivalent of a payment made in liquidation of the interest of a retiring or deceased partner, unless such liability resulted in the creation of, or the increase in, the basis of any property. The liability is excluded, however, to the extent incurring the liability results in the creation of, or an increase in, the basis of any property.

2237. Dividend Distribution in Reorganization. A distribution of money or other property ("boot") to a stockholder as part of a plan of reorganization (¶ 2229) may be taxed as a dividend if it has the effect of a taxable dividend, even if the money or other property is received in an exchange which is, in part, tax free (Code Sec. 356; Reg. § 1.356-1).[37] The constructive ownership rules discussed at ¶ 743 are applied in determining dividend equivalency. For this purpose, a distribution is taxable as a dividend, not to exceed the recognized gain, to the extent the distributing company has earnings and profits sufficient to cover the distribution.

2241. Liquidation as Part of Reorganization. Under a plan of reorganization (¶ 2209), a corporation often acquires, for all or part of its stock, all of the stock in another corporation from the stockholders of the latter. As the final step in the reorganization, the acquiring corporation may liquidate the latter company, acquiring those assets by surrendering its own stock. This last step in the reorganization may be accomplished tax free under Code Sec. 332 (¶ 2261).

2247. Reorganizations of Bankrupt or Insolvent Corporations. Corporate restructurings ordered pursuant to certain bankruptcy, foreclosure, or similar proceedings may qualify as corporate reorganizations (¶ 2209) (Code Sec. 368(a)(1)(G)).[38] To qualify for nonrecognition treatment, a G reorganization must meet six requirements:

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[34] ¶ 16,402; CCORP: 3,102.05
[35] ¶ 16,550; CCORP: 39,256
[36] ¶ 16,520; CCORP: 39,252.15, CCORP: 39,302.20; § 26,125.05
[37] ¶ 16,490, ¶ 16,491; CCORP: 39,254.15
[38] ¶ 16,750; REORG: 27,050

Reporting Requirement. A participating FFI is required to report annually to the IRS the name, address, and taxpayer identification number (TIN) of each holder of a U.S. account which is a specified U.S. person. In the case of any account holder which is a U.S.-owned foreign entity, the participating FFI must report the name, address, and TIN of each substantial U.S. owner of the entity (Code Sec. 1471(c); Reg. §1.1471-4(d) and (i)). The FFI must also report the account number, the year-end account balance or value in U.S. dollars, and the gross amount and character of dividends, interest, or other income paid or credited to the account. This includes the gross proceeds from the sale or redemption of property paid or credited to the account. Special rules are provided for a participating FFI to report information regarding its recalcitrant account holders. If an FFI is prohibited by foreign law from reporting the required information with respect to an account, then it must close the account within a reasonable period of time or must otherwise block or transfer the account.

A participating FFI reports the required information on Form 8966 with respect to each account maintained at any time during the calendar year. The form must be filed electronically with the IRS by March 31 of the year following the end of the calendar year to which it relates. Form 8809 is used to request a 90-day extension. Special reporting rules, however, apply for U.S. accounts and accounts held by owner-documented FFIs maintained during the 2014 and 2015 calendar years if the effective date of the FFI agreement of the participating FFI is on or before December 31, 2015 (Temp. Reg. §1.1471-4T(d)(7)). As an alternative to filing Form 8966, the FFI may elect to be subject to the same reporting requirements of U.S. institutions. Thus, the institution must provide a full Form 1099 reporting for every account with a U.S. person or U.S. foreign entity as an account holder. As a result, both U.S. and foreign source amounts (including gross proceeds) are subject to reporting under this election regardless of whether the amounts are paid inside or outside the United States.

Withholding Requirement. A participating FFI is required to deduct and withhold 30 percent from any withholdable payment (¶ 2469) made by the FFI to an account held by a recalcitrant account holder or to a nonparticipating FFI after June 30, 2014 (Temp. Reg. §1.1471-4T(b)(1)). If an FFI is prohibited by foreign law from withholding as required with respect to an account, then it must close the account within a reasonable period of time or must otherwise block or transfer the account (Reg. §1.1471-4(a)(1)). A participating FFI is not required to deduct and withhold tax on a foreign pass-through payment made by the FFI to an account held by a recalcitrant account holder or to a nonparticipating FFI before the later of January 1, 2017, or the date final regulations are issued defining foreign pass-through payments. A participating FFI may elect not to withhold on any withholdable payments, but instead have a U.S. withholding agent withhold tax on payments the electing FFI receives which are allocable to a recalcitrant account holder or a nonparticipating FFI (Code Sec. 1471(b)(3)).

2473. FATCA Reporting and Withholding Obligations for Non-Financial Foreign Entities (NFFEs). Under the Foreign Account Tax Compliance Act (FATCA), if a non-financial foreign entity (NFFE) is the beneficial owner of a withholdable payment (¶ 2469) made to the NFFE after June 30, 2014, then the NFFE is required to report certain information to the withholding agent (Code Sec. 1472(b); Reg. §1.1472-1; Temp. Reg. §1.1472-1T).[101] The reporting requirement is satisfied if the NFFE reports the name, address, and taxpayer identification number (TIN) of each substantial U.S. owner or if it certifies that it does not have any substantial U.S. owners. If the NFFE or other payee fails to meet the reporting requirement, then the withholding agent must deduct and withhold a tax of 30 percent from the withholdable payment.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[101] ¶ 32,888, ¶ 32,890, ¶ 32,890B; INTL: 36,100; §37,730

An NFFE for this purpose is any foreign entity that is not a financial institution, meaning the entity does not accept deposits in the ordinary course of a banking business, does not hold financial assets for the account of others as a substantial part of its business, and is not engaged primarily in investing. A substantial U.S. owner is:

- in the case of a corporation, a U.S. person that owns, directly or indirectly, more than 10 percent of the corporate stock by vote or value;
- in the case of a partnership, a U.S. person that owns directly or indirectly, more than 10 percent of the capital or profits interests of the partnership; and
- in the case of a trust, a U.S. person treated as an owner of any portion of the trust under the grantor trust rules and any U.S. person holding more than 10 percent of the beneficial interests (Code Sec. 1473(2); Reg. §1.1473-1(b)).[102]

A withholding agent that receives information about substantial U.S. owners of an NFFE must report the information to the IRS on or before March 15 of the calendar year following the year in which the withholdable payment is made. This includes the name of the NFFE and the name, TIN, and address of each U.S. substantial owner. If withholding is required, Form 1042 is used to report and pay taxes withheld during the tax year. In addition, an annual information return must be filed on Form 1042-S and a copy furnished to the recipient of the withholdable payment (Code Sec. 1472(b); Reg. §1.1472-1(e)).[103]

So long as the NFFE and the withholding agent satisfy their reporting requirements, withholding is not required unless the withholding agent knows or has reason to know that any information provided about substantial U.S. owners is incorrect. A withholding agent is also not required to withhold taxes if the withholding agent may treat the payment as beneficially owned by an excepted NFFE. An excepted NFFE includes a publicly traded corporation and its related entities, territory entities, the government of a foreign country or U.S. possession, an international organization, or any foreign central bank of issue. Additionally, active NFFEs, direct reporting NFFEs and sponsored direct NFFEs are excepted NFFEs (Code Sec. 1472(c); Reg. §1.1472-1(c); Temp. Reg. §1.1472-1T(c)). An active NFFE is any NFFE if less than 50 percent of its gross income for the preceding tax year is passive income, and less than 50 percent of its assets produce or are held for the production of dividends, interest, rents and royalties (other than those derived in the active conduct of a trade or business), annuities, or other passive income. A direct reporting NFFE elects to report directly to the IRS. A sponsored direct reporting NFFE is a direct reporting NFFE with a sponsoring entity that acts on its behalf. In addition, entities which are by definition not financial institutions are considered excepted NFFEs, including certain holding companies, start-up companies, NFFEs that are liquidating or emerging from reorganization or bankruptcy, and certain hedging entities.

Withholding is not required with respect to any payment under a grandfathered obligation or from any gross proceeds from the disposition of such an obligation. A grandfathered obligation is any legal obligation outstanding on July 1, 2014, that produces or could produce a withholdable payment or pass-through payment. It does not include any instrument treated as equity for U.S. tax purposes or any legal agreement that lacks a definitive expiration or term (Reg. §1.1471-2(b); Temp. Reg. §1.1471-2T(b)).[104]

Foreign Tax Credit or Deduction

2475. Foreign Tax Credit or Deduction. Subject to certain limitations (¶ 2479), a U.S. taxpayer may elect a credit or deduction against U.S. income liability for foreign taxes paid or accrued to a foreign country or U.S. possession during the tax year (Code Sec. 901; Reg. §1.901-1).[105] The credit and deduction are intended to relieve U.S.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[102] ¶ 32,893, ¶ 32,895; INTL: 36,060; §37,730

[103] ¶ 32,888, ¶ 32,890; INTL: 36,100; §37,730

[104] ¶ 32,884H, ¶ 32,884J; INTL: 36,100; §37,730

[105] ¶ 27,820, ¶ 27,821; INTLOUT: 3,050; §13,401

return for the second tax year for which the individual had earnings from self-employment of $400 or more from religious activities (Code Sec. 1402(e)). An individual who has conscientious objections to insurance by reason of an adherence to established tenets or teachings of a religious sect of which he or she is a member may also be exempt from the self-employment tax (Code Sec. 1402(g)).

Services performed by employees for a church or church-controlled organization may be excluded from Social Security coverage if the church or organization makes a valid election under Code Sec. 3121(w) to be exempt from the employer portion of FICA taxes. However, such employees remain liable for FICA or self-employment tax on remuneration paid for such services unless the remuneration is less than $100 per year (Code Sec. 1402(a)(14) and (j)).[87]

A U.S. citizen who works for an employer that is exempt from the Social Security tax because it is either a foreign government or instrumentality or an international organization is treated as self-employed (Code Sec. 1402(c)(2)).[88] Nonresident aliens are not subject to self-employment tax, but the tax may apply to a resident of Puerto Rico, the Virgin Islands, Guam or American Samoa who is not a citizen of the United States (Code Sec. 1402(b)).[89]

2670. Self-Employment Income. The self-employment tax (¶ 2664) is imposed on self-employment income derived from an individual during the tax year. Self-employment income is generally defined as net earnings from self-employment which consists of: (1) the gross income derived from any trade or business, less allowable deductions attributable to the trade or business, and (2) the taxpayer's distributive share of the ordinary income or loss of a partnership engaged in a trade or business (Code Sec. 1402(b); Reg. §1.1402(a)-1).[90] The term trade or business does not include services performed as an employee other than services relating to certain newspaper and magazine sales, sharing of crops, foreign organizations, and sharing of fishing catches (Code Sec. 1402(c)(2)).[91]

There are special rules for computing net earnings from self-employment, including a special optional method of computing net earnings from nonfarm self-employment (¶ 2673) (Code Sec. 1402(a).[92] Rents from real estate and from personal property leased with the real estate, and the attributable deductions, are excluded from net earnings from self-employment unless received by the individual in the course of his business as a real estate dealer. Rental real estate income that is otherwise excludable does not become self-employment income merely because it is held in a qualified joint venture (¶ 402) (CCA 200816030).

Dividends and interest from any bond, debenture, note, certificate or other evidence of indebtedness issued with interest coupons or in registered form by any corporation are excluded from net earnings from self-employment income unless received by a dealer in stocks and securities in the course of his business. Other interest received in the course of any trade or business is not excluded. Gain or loss from the sale or exchange of property that is not stock in trade or held primarily for sale is excluded, as is gain or loss from the sale or exchange of a capital asset.

Termination payments received by former insurance salespersons are excludable from net earnings from self-employment if the amount is received after the termination of the individual's agreement to perform services for the company and the individual performs no services for the company after the termination and before the close of the tax year. In addition, the payment must be conditioned upon the salesperson agreeing not to compete with the company for at least one year following termination. The payment amount must also depend primarily on policies sold by or credited to the individual during the last year of the agreement and/or the extent to which the policies remain in force for some period after the termination and does not depend on the length

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[87] ¶ 32,560; INDIV: 63,308; §23,045.10
[88] ¶ 32,560; INDIV: 63,154; §23,045.10
[89] ¶ 32,560; INDIV: 63,302; §23,110.20
[90] ¶ 32,560, ¶ 32,561; INDIV: 63,100; §23,205
[91] ¶ 32,560; INDIV: 63,154; §23,045.10
[92] ¶ 32,560; INDIV: 63,050; §23,210.05

of service or overall earnings from services performed for the company (Code Sec. 1402(k)).[93]

Even though the rental value of a parsonage (¶ 875) and the value of meals and lodging furnished for the convenience of the employer (¶ 2089) are not included in a minister's gross income for income tax purposes, they are taken into account in calculating net earnings from self-employment (Code Sec. 1402(a)(8)).[94] The same is true of amounts excluded from gross income as foreign earned income (¶ 2402). However, self-employment income does not include a minister's retirement benefits received from a church plan or the rental value of a parsonage allowance as long as each was furnished after the date of retirement.

One business deduction that cannot be taken in calculating net earnings from self-employment for the tax year is the deduction allowed for self-employment tax paid during the year (¶ 923). However, the law provides a substitute for that deduction. This is an amount determined by multiplying net earnings from self-employment (calculated without regard to the substitute deduction) by one-half of the self-employment tax rate (Code Sec. 1402(a)(12)).[95] Thus, the deduction equals 7.65 percent of the net earnings from self-employment. The rate of the adjustment is 7.65 percent in 2011 and 2012 even though the self-employment tax rate was reduced (¶ 2664) (Act Sec. 601 of P.L. 111-312, amended by Act Sec. 1001 of P.L. 112-96). Similarly, for tax years beginning after 2012, taxpayers who reduce self-employment income by an amount equal to one-half of the combined self-employment tax rate do not include the additional 0.9 percent Medicare tax in the rate used to make such computation.

Example: Aileen Smith, a self-employed individual, has $40,000 of net earnings from self-employment during the year (determined without regard to the substitute deduction). Her self-employment tax is computed as follows:

Self-employment net earnings	$40,000
Less: $40,000 × 7.65%	3,060
Reduced self-employment net earnings	$36,940
Tax rate on self-employment income	× 15.3%
Self-employment tax	$5,652

2673. Optional Method for Nonfarm Self-Employment. A taxpayer may be able to use an optional method to compute net earnings from self-employment if the net earnings from nonfarm self-employment for 2014 are less than $4,800 ("lower limit") and less than two-thirds of gross nonfarm income. In addition, the optional method may only be used if the taxpayer had net earnings from self-employment of $400 or more in at least two of the three years immediately preceding the year in which the nonfarm optional method is elected (Code Sec. 1402(a) and (l)).[96]

If the taxpayer is eligible to use the optional method, he or she may report two-thirds of the gross income from the nonfarm business as net earnings from self-employment, provided the gross income from all nonfarm trades or businesses for 2014 is $7,200 ("upper limit") or less. If, however, the gross income from all nonfarm trades or businesses is more than $4,800, the individual may report $4,800 as net earnings from nonfarm self-employment. The optional nonfarm method may not be used to report an amount less than actual net earnings from self-employment. The purpose of this optional method is to permit taxpayers to pay into the Social Security system and thus obtain or increase their benefits, even though they are not otherwise eligible because their net self-employment income is under $400. This optional method may not be used more than five times by any individual. Note that the $4,800 amount refers to net earnings after reduction by the 7.65 percent deduction amount (¶ 2670).

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[93] ¶ 32,560; INDIV: 63,100; §23,210.25
[94] ¶ 32,560; INDIV: 63,402; §23,505.05
[95] ¶ 32,560; INDIV: 63,060; §23,210.30
[96] ¶ 32,560; INDIV: 63,056; §23,215.10

constitutes prima facie evidence that the petition was delivered to the Tax Court (Reg. § 301.7502-1).[127]

If a taxpayer has filed a Tax Court petition before a jeopardy assessment or levy is made, the Tax Court is given concurrent jurisdiction with the federal district courts with respect to the taxpayer's challenge of the jeopardy assessment or levy (Code Sec. 7429(b)(2)).[128] Similarly, if there is a premature assessment of tax made while a proceeding with respect to that tax is pending in the Tax Court, the Tax Court has concurrent jurisdiction with the federal district court to restrain the assessment and collection of tax (Code Sec. 6213).[129]

2782. Burden of Proof. The IRS has the burden of proof in the Tax Court with respect to a factual issue that is relevant to determining a taxpayer's tax liability if the taxpayer presents credible evidence with respect to that issue *and* satisfies three applicable conditions (Code Sec. 7491):[130]

(1) The taxpayer must comply with the substantiation and recordkeeping requirements of the Code and regulations.

(2) The taxpayer must cooperate with reasonable requests by the IRS for witnesses, information, documents, meetings and interviews.

(3) Taxpayers *other than individuals* must meet the net worth limitations that apply for awarding attorneys' fees under Code Sec. 7430. Thus, corporations, trusts, and partnerships whose tax worth exceeds $7 million cannot benefit from this provision.

Further, in any court proceeding where the IRS solely uses statistical information from unrelated taxpayers to reconstruct an item of an *individual* taxpayer's income, such as the average income for taxpayers in the area in which the taxpayer lives, the burden of proof is on the IRS with respect to that item of income. Also with respect to individuals, the IRS must initially come forward with evidence that it is appropriate to apply a penalty, addition to tax, or additional amount before the court can impose the penalty.

In cases in which the burden of proof does not shift to the IRS, the taxpayer generally has the burden of proof in the Tax Court. However, a taxpayer must only establish that the IRS is in error and not whether any tax is owed (Tax Court Rule 142).[131] The IRS bears the burden of proof with respect to any new matter, increase in deficiency, or affirmative defenses raised in its answer. Further, the burden of proving fraud and liability as a transferee is upon the IRS (Code Secs. 6902 and 7454).[132] The IRS also has the burden of proof in proceedings involving a manager of a private foundation where the manager knowingly participated in an act of self-dealing, participated in an investment which jeopardizes the carrying out of an exempt purpose, or agreed to the making of a taxable expenditure.

2784. Small Tax Cases. The Tax Court maintains relatively informal procedures for the filing and handling of cases where neither the tax deficiency in dispute (including additions to tax and penalties) nor the amount of claimed overpayment exceeds $50,000. Usually taxpayers represent themselves, although they may be represented by anyone admitted to practice before the Tax Court. Each decision is final and cannot be appealed by either the taxpayer or the government (Code Sec. 7463).[133] The filing fee is $60 (¶ 2776).

2786. Appeal from Tax Court Decision. A taxpayer who loses in the Tax Court may appeal the case (unless the case was tried as a small tax case, ¶ 2784) to the proper U.S. Court of Appeals by filing a notice of appeal with the clerk of the Tax Court. The notice must be filed within 90 days after the Tax Court decision is entered. However, if one party to the proceeding files a timely notice of appeal, any other party to the

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[127] ¶ 42,621; LITIG: 6,214
[128] ¶ 41,725; IRS: 54,204
[129] ¶ 37,545; LITIG: 6,136
[130] ¶ 42,515; LITIG: 3,200
[131] ¶ 42,302, ¶ 42,302.615; LITIG: 6,704
[132] ¶ 40,780, ¶ 42,081; LITIG: 6,708
[133] ¶ 42,118; LITIG: 7,000

proceeding may take an appeal by filing a notice of appeal within 120 days after the decision of the Tax Court is entered (Code Sec. 7483).[134] A taxpayer who wants the assessment postponed pending the outcome of the appeal must file an appeal bond with the Tax Court guaranteeing payment of the deficiency as finally determined (Code Sec. 7485).[135]

2788. Acquiescence and Nonacquiescence by Commissioner. The IRS may announce in the Internal Revenue Bulletin if it has decided to acquiesce or not acquiesce in a regular decision of the Tax Court. Any acquiescence or nonacquiescence may be withdrawn, modified, or reversed at any time and any such action may be given retrospective, as well as prospective, effect.[136]

An acquiescence or nonacquiescence relates only to the issue or issues decided adversely to the government. Acquiescence means the IRS accepts the conclusion reached and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions. Acquiescences are to be relied on by IRS officers and others concerned as conclusions of the IRS only with respect to the application of the law to the facts in the particular case.

2790. Suits for Refund of Tax Overpayments. After the IRS rejects a refund claim for an alleged tax overpayment, suit can be maintained in the U.S. Court of Federal Claims or a U.S. District Court. A suit may be brought in the Court of Federal Claims against the United States to recover any overpayment of tax, regardless of amount (Judicial Code Sec. 1491).[137] Final decisions of the U.S. Court of Federal Claims are appealable to the U.S. Court of Appeals for the Federal Circuit (Judicial Code Sec. 1295).[138] All civil actions against the United States for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected may be brought against the United States as defendant in a U.S. District Court with right of trial by jury in any action if either party makes a specific request for a jury trial (Judicial Code Secs. 1346 and 2402).[139] Filing a proper claim for refund or credit (¶ 2759) is a condition precedent to a suit for recovery of overpaid taxes (Code Sec. 7422(a)).[140]

If, prior to the hearing on a taxpayer's refund suit in a District Court or the Court of Federal Claims, a notice of deficiency is issued on the subject matter of the taxpayer's suit, then the District Court or Court of Federal Claims proceedings are stayed during the period of time in which the taxpayer can file a petition with the Tax Court (¶ 2778) and for 60 days thereafter. If the taxpayer files a petition with the Tax Court, then the District Court or the Court of Federal Claims loses jurisdiction as to any issues over which the Tax Court acquires jurisdiction. If the taxpayer does not appeal to the Tax Court, the United States may then counterclaim in the taxpayer's suit within the period of the stay of proceedings even though the time for such pleading may otherwise have expired (Code Sec. 7422(e)).[141]

2792. Time to Bring Suit. A suit or proceeding based upon a refund claim must be brought within two years from the date the IRS mails, by registered or certified mail, notice of disallowance of the part of the claim to which such suit or proceeding relates or within two years from the date the taxpayer waives notification of disallowance of his or her claim (Code Sec. 6532(a)).[142] The two-year period of limitations for filing suit may be extended by written agreement between the taxpayer and the IRS. Unless a bankruptcy proceeding has begun, no action can be brought before the expiration of six months from the date of filing the refund claim unless the IRS renders a decision on the claim before the six months are up. In bankruptcy proceedings, the six-month period is reduced to 120 days.

References are to Standard Federal Tax Reports; Tax Research Consultant; and Practical Tax Explanations.

[134] ¶ 42,477; LITIG: 6,960
[135] ¶ 42,500; LITIG: 6,966
[136] ¶ 43,282.20; IRS: 12,354
[137] ¶ 41,571; LITIG: 9,050
[138] ¶ 41,555; LITIG: 9,210
[139] ¶ 41,560, ¶ 41,589; LITIG: 9,052
[140] ¶ 41,685; LITIG: 9,056
[141] ¶ 41,685; LITIG: 3,102, LITIG: 9,106
[142] ¶ 39,270; LITIG: 9,058; § 40,010.25