Chapter 8: Related Parties

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Corrections were made to this workbook through January of 2010. No subsequent modifications were made.

INTRODUCTION

There are many provisions in the Internal Revenue Code that concern related parties. Many of these provisions have their own definitions of who is considered a "related party." Two of the most far-reaching definitions are found in IRC §§267 and 318. Although many related-party passages refer to these two code sections, they make modifications to the parameters of the definition. For example, a provision may substitute an "80% or more ownership" test for the "more than 50% ownership" test found in a particular Code section. Consequently, it is important to check the specific related-party definition for each relevant provision.

WHO IS RELATED?

When we hear the term "related parties," we typically think of the taxpayer and family members, including the spouse, parents, grandparents, children, and grandchildren. However, related parties may also include brothers and sisters and their children, and, in many cases, entities in which the taxpayer owns a majority interest.

Additionally, related parties include entities in which the taxpayer does not directly own a majority interest, but has a majority interest when indirect ownership is taken into account. The indirect-ownership test is one that Congress added in order to eliminate a loophole. The loophole involved taxpayers who did not own a majority interest in an entity directly but instead had the direct ownership divided among family members so that the related-party rules would not apply. Congress plugged this loophole by including indirect ownership in the ownership calculations.

"Indirect ownership" generally means the taxpayer is considered to own any interest held by other related parties. An indirect ownership is taken into account at only one level. Consequently, an indirect ownership determined to belong to one person does not in turn belong to another person related to the first indirect owner.

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Example 1. Walter directly owns 40% of stock in ABC Corporation. Walter's daughter Melodie owns none of the stock directly but indirectly owns this same stock and therefore has a 40% ownership in ABC Corporation. Melodie's husband, Eric, does not own any of the stock directly. None of Walter's ownership is attributed to him since the relationship between Eric and Walter (in-laws) is generally not one of the related parties for attribution and because the indirect ownership was already attributed to Melodie.

IRC §267 RELATIONSHIPS

IRC §267(b) has 13 different relationships that make up related parties. These are:

1. Members of a family, including:
   - Husband and wife;
   - Brothers and sisters — including half-siblings;
   - Ancestors — parents, grandparents, etc.; and
   - Lineal descendants — children (including adopted children),[1] grandchildren, etc.;
2. An individual and a corporation in which the individual owns, directly or indirectly, more than 50% of the value of the outstanding stock;
3. Two corporations which are members of the same controlled group;
4. A grantor and a fiduciary of any trust;
5. A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
6. A fiduciary of a trust and a beneficiary of the trust;
7. A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
8. A fiduciary of a trust and a corporation in which more than 50% of the value of the outstanding stock is owned, directly or indirectly, by or for the trust or a person who is a grantor of the trust;
9. A person and an organization to which IRC §501 applies and which is controlled directly or indirectly by such person or by members of the family of such individual;
10. A corporation and a partnership if the same persons own more than 50% of the value of the outstanding stock of the corporation and more than 50% of the capital or profits interest in the partnership;
11. An S corporation and another S corporation, if the same persons own more than 50% of the value of the outstanding stock of each corporation;
12. An S corporation and a C corporation, if the same persons own more than 50% of the value of the outstanding stock of each corporation; or
13. An executor of an estate and a beneficiary of such estate, except in the case of a sale or exchange in satisfaction of a pecuniary bequest.

A sale between a taxpayer and a stepparent is not a sale between related parties because the stepparent is not considered a part of the taxpayer's family.[2]

The Tax Court ruled that a sale between a taxpayer and his wife's grandson through another marriage was not a sale to a related party. IRC §267 does not include a stepgrandchild as part of the taxpayer's family.[3]

1. Treas. Reg §1.267(c)-1(a)(4).
2. Rev. Rul. 71-50, 1971-1 CB 106.
3. *DeBoer v. Comm'r*, TC 662 (1951).

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IRC §318 RELATIONSHIPS

IRC §318 concerns constructive ownership of stock. The relationships that make up the related parties under §318 include:

- **Members of a family.** This includes husband and wife, ancestors, and lineal descendants. The definition under §318 does **not** include brothers and sisters. The constructive ownership rules do not provide for attribution beyond the taxpayer's parents. This means the parents' stock is attributed to the taxpayer, but the grandparents' stock is not attributed.
- **Attribution from partnerships and estates.** Stock owned, directly or indirectly, by or for a partnership or estate is considered owned proportionately by its partners or beneficiaries.
- **Attribution from trusts.**
    - Stock owned, directly or indirectly, by or for a trust is considered as owned by its beneficiaries in proportion to the beneficiaries' interests in the trust. This rule does not apply to IRC §401(a) employees' trusts.
    - Stock owned, directly or indirectly, by or for any portion of a trust of which a grantor of a trust is treated as a substantial owner is considered as owned by the grantor.
- **Attribution from corporations.** If 50% or more of the value of a corporation's stock is owned, directly or indirectly, by or for a person, that person is considered to own any stock that the corporation owns, directly or indirectly, in proportion to the person's ownership interest in the corporation's stock.
- **Attribution to partnerships and estates.** Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate is considered as owned by the partnership or estate.
- **Attribution to trusts.**
    - Stock owned, directly or indirectly, by or for a beneficiary of a trust is considered as owned by the trust, unless the beneficiary's interest is a remote contingent interest (5% or less of the value of the trust property).
    - Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust is considered as owned by the person.
- **Attribution to corporations.** If 50% or more of the value of a corporation's stock is owned, directly or indirectly, by or for any person, the corporation is considered to own the stock owned by or for such person.

OWNERSHIP INSIDE PASS-THROUGH ENTITY

For purposes of both §§267 and 318, any ownership inside a pass-through entity, such as a partnership, is deemed to be owned directly by the entity's owners on a proportionate basis. For example, a 20% owner of a partnership owns 20% of any entity the partnership owns.

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TIMING OF DEDUCTIONS FOR PAYMENTS BETWEEN RELATED PARTIES

Accrual-basis taxpayers generally can claim a deduction for vacation pay, salaries, and other expenses accrued as of the last day of the tax year if these items are paid within the first 2½ months after the end of the year. For example, an accrual of these expenses on December 31, 2009, can be deducted if they are actually paid by March 15, 2010.

IRC §267(a)(2) sets specific rules for these accrued expenses when related parties (within the meaning of §267(b) described above) are involved. In brief, it states that an accrual-basis taxpayer **cannot** take the deduction until the date the cash-basis related party is required to include the amount in income.

> **Example 2.** Able Corporation (Able), an accrual-basis corporation, is owned 100% by Nanette, a cash-basis individual. According to the employment contract between Able and Nanette, a bonus is due to Nanette as of December 31, 2009. Part of the bonus computation, as shown in the employment contract, is tied to the profits of Able. Since the profits have not been calculated as of the close of business, Able does not pay the bonus until February 3, 2010. On its books for the year ending December 31, 2009, Able can accrue the bonus to Nanette, but it cannot claim a deduction for the bonus on its tax return. Under §267(a)(2), Able is allowed the deduction for the year that includes February 3, 2010, the date Nanette receives the income. Since February 3, 2010, falls into Able's tax year ending December 31, 2010, it takes the deduction on its 2010 income tax return.

SALES BETWEEN RELATED PARTIES

When a taxpayer sells business or investment property at a **gain,** the seller recognizes the gain and pays taxes according to the normal gain rules. This is generally true regardless of whether the buyer is a related party or not (except when IRC §1239 applies, as discussed later).

When a taxpayer sells business or investment property at a **loss,** the seller is normally allowed to claim the loss on her income tax return, subject to applicable limitations such as the capital loss limits. However, when a taxpayer sells the property to a related party, the loss is denied under §267.

> **Example 3.** Dorothy has a basis in non-publicly traded stock of $10,000 when she sells it to her sister, Mary, for $8,000. Since Dorothy and Mary are related parties under §267, Dorothy is not allowed to claim a loss on the stock sale. Mary's basis cannot be determined until she disposes of the stock (see **Examples 4, 5,** and **6**).

The denial of a loss when sales involve related parties has one exception. When a corporation distributes property to a shareholder, it is deemed to be a "sale" of the property with the "sales price" equal to the FMV of the property. If this creates a loss, the loss is nondeductible due to the related-party rules. However, if the property is distributed as part of a **complete liquidation** of the corporation, the related-party rules are not applicable and the corporation is permitted the loss from the deemed sale.

> **Note.** IRC §267 does not apply to a distribution of loss property in a complete corporate liquidation. The rules of §§336 or 337 determine the extent of the permitted loss deduction, although §267 is cited as the reference to related parties.[4]

4. IRC §336(d)(1)(A).

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RESALE BY RELATED PARTY

When a person purchases property from a related party at arm's length, the buyer's basis in that property is normally the buyer's cost of the property. If the purchaser sells the property for a loss, no adjustment is necessary.

If the property's sale or disposition results in a gain, the recipient can increase the property's adjusted basis by the amount of the transferor's disallowed loss, if any, thereby minimizing the taxable gain. **If property is purchased from a related person who had a disallowed loss and the purchaser later sells or exchanges the property at a gain, the gain is recognized only to the extent it is more than the loss previously disallowed to the related person.**[5]

Example 4. Use the same facts as **Example 3.** A year after Dorothy sells her stock to Mary, Mary sells the stock for $5,000. Mary has a loss of $3,000 ($5,000 selling price less Mary's basis of $8,000). Dorothy's remaining $2,000 basis is lost.

Example 5. Use the same facts as **Example 4,** except Mary sells the stock for $15,000. Mary has a gain of $5,000.

$15,000 selling price
− $10,000 basis ($8,000 original cost + $2,000 disallowed loss from Dorothy)
$5,000 gain

Example 6. Use the same facts as **Example 5,** except Mary sells the stock for $9,000. This sale results in no gain and no loss because Mary's $1,000 gain from the sale is less than Dorothy's $2,000 disallowed loss.

DISPOSITION OF PASSIVE ACTIVITY

When there is a disposition of a passive activity to a related party, any suspended losses incurred in the transaction remain with the original seller. The taxpayer recognizes the suspended loss when the related party who acquired the passive activity disposes of it to an unrelated person.[6]

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5. IRS Pub. 544, *Sales and Other Dispositions of Assets* (2008).
6. IRC §§469(g)(1)(B) and 267.

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REASONABLE RENTAL EXPENSES

IRC §162(a)(3) allows a deduction for:

> *. . . all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including. . . rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.*

When rental payments are determined to be unreasonable, the courts have held that they are not ordinary and necessary.

When the parties to a lease are at arm's length, the issue of reasonableness is not usually considered. However, when the lessor and lessee are related companies, family members, or a corporation and its shareholders, the terms of the lease must be carefully structured to avoid the implication that the rents are something other than true rents.

In *Roland P. Place*,[7] the court stated, "When there is a close relationship between lessor and lessee and in addition there is no arm's length dealing between them, an inquiry into what constitutes reasonable rental is necessary to determine whether the sum paid is in excess of what the lessee would have been required to pay had he dealt at arm's length with a stranger." Methods of determining reasonable rental include:

- A consideration of whether the rent paid by a related party matches the prevailing market rates of comparable properties,
- Appraisals conducted by real estate professionals to determine fair rental values, and
- An analysis of whether the amount of rent paid is reasonable in relation to the business activities of related companies.

Rental payments that are found to be unreasonable are not deductible to the extent they are excessive.[8] This means that a portion of the lessee's rent deduction, if found to be unreasonable, will be disallowed. However, in these situations, the IRS is under no obligation to reduce the corresponding rental income of the lessor.

RENTAL OF PERSONAL RESIDENCE

If the taxpayer rents out her residence for less than 15 days during the taxable year, the income from the rental is not included in gross income and any deductions from the rental are disallowed.[9] However, interest expense and property taxes may be deductible on Form 1040, Schedule A.

If the taxpayer's residence is used by the taxpayer or her relatives for the greater of 14 days or 10% of the total number of days the home is rented out during the year for a fair rental rate, rental deductions are limited. In such cases, §280A applies and generally limits losses to net income.

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7. *Roland P. Place v. Comm'r*, 17 TC 199, 203, *aff'd*, 6th Cir., 199 F.2d 373, *cert denied*, 344 U.S. 927, 73 S. St. 496, 97 L.Ed. 714. (1951).
8. *Velvet Horn, Inc. v. Comm'r*, 41 TC Memo 1981-227 (May 6, 1981).
9. IRC §280A(g).

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TRANSFERS BETWEEN SPOUSES OR EX-SPOUSES

IRC §267(a)(1) does not apply to any transfer described in §1041(a) relating to transfers of property between spouses or incident to divorce.[10]

TRANSFERS

IRC §1041 provides the rules for transfers of property between spouses or former spouses. The current rules became effective for transfers of property on or after July 19, 1984.

The current rules are applicable to a transfer between spouses or a transfer between former spouses if the transfer is incident to a divorce or legal separation. A transfer is "incident to the divorce" if:

- It takes place within one year after the marriage ends, or
- It is related to the cessation of the marriage.[11]

Temp. Treas. Reg. §1.1041-1T(b)(Q-7) defines a transfer related to the cessation of the marriage as a transfer pursuant to the divorce or separation instrument which takes place within the first six years after the date the marriage ceases. For this purpose, a modified divorce or separation instrument is also considered the original instrument.

A transfer pursuant to the divorce or separation instrument that does not take place within the first six years after the date the marriage ceases is considered a transfer that is not related to the cessation of the marriage. This position can be rebutted if the taxpayer can show the transfer is made to effect the division of the property owned by the former spouse at the time of the cessation of the marriage. The regulations provide an example of a rebuttal of the presumption in which a transfer was not made within the 6-year period because of factors which hampered an earlier transfer of the property, such as legal or business impediments to the transfer or disputes concerning the value of the property owned at the time of the cessation of the marriage, and a prompt transfer is made after the impediment is removed.

IRC §1041 provides that there is neither gain nor loss in connection with such a transfer. The recipient spouse has a new basis in the property received equal to the transferor spouse's adjusted basis of the property on the date of the transfer. These rules apply regardless of whether or not the spouses or former spouses acted at arm's length, conducted an actual sale or intended the transfer as a gift, or received comparable value for the property transferred. This "no gain, no loss" rule applies regardless of whether the property's FMV is higher or lower than the transferring spouse's adjusted basis.

These rules do not apply if the spouse or former spouse of the person making the transfer is a nonresident alien. In such situations, the transferor spouse either has made a gift (if that was the spouse's intent) or a sale (if the transferred property was sold to the recipient spouse for its FMV). If the property was sold for less than its FMV, it could be a part gift and part sale.

> **Note.** The transferring spouse is required to provide the recipient spouse with the records that substantiate the adjusted basis and the holding period for the property as of the date of the transfer.[12] Valuable records could include the original purchase document, purchase documents for improvements, and the depreciation schedule.

Any transfers between spouses or former spouses that do not meet the provisions of §1041 stand on their own as gifts or sales.

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10. IRC §267(g).
11. IRC §1041(c).
12. Temp. Treas. Reg. §1.1041-1T(e)(Q&A-14).

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Example 7. Samantha gave Rental Property A to her husband, Carl, when it was worth $150,000. Samantha has an original cost of $100,000 in Rental Property A. She had claimed $20,000 of depreciation up to the date of the transfer. Carl's cost in the property is $100,000, and he is deemed to have claimed $20,000 of prior depreciation. The fact that the property was worth $150,000 on the date of the transfer is not taken into account for any purpose.

The result would be the same if Samantha and Carl were divorced, and the transfer was a requirement of the divorce decree or legal separation document and took place within six years of the end of the marriage.

SALES OR EXCHANGES OF DEPRECIABLE PROPERTY

IRC §1239 involves sales or exchanges of property between related persons. It requires a transferor to report a gain from a sale or exchange as ordinary income if the property is subject to IRC §167 depreciation in the hands of the transferee.

For this purpose, "related persons" includes the following:

- A person and all controlled entities with respect to such person;
- A taxpayer and any trust in which the taxpayer (or taxpayer's spouse) is a beneficiary, unless the beneficiary's interest in the trust is a remote contingent interest;
- An executor of an estate and a beneficiary of such estate;
- An employer and any person related to the employer that falls into any of the above categories; and
- A welfare benefit fund under IRC §419(e) which is controlled directly or indirectly by an employer or any person related to the employer.

A "controlled entity" with respect to any person includes:

- A corporation in which more than 50% of the value of the outstanding stock is owned (directly or indirectly) by or for such person;
- A partnership in which more than 50% of the capital interest or profits interest is owned (directly or indirectly) by or for such person;
- Two corporations which are members of the same controlled group;
- A corporation and a partnership, if the same persons own:
    - More than 50% of the value of the outstanding stock of the corporation; and
    - More than 50% of the capital interest or the profits interest in the partnership;
- An S corporation and another S corporation if the same persons own more than 50% of the value of the outstanding stock of each corporation; and
- An S corporation and a C corporation, if the same persons own more than 50% of the value of the outstanding stock of each corporation.

Note. Under Treas. Reg. §1.1239-1, the list of related persons included husband and wife. This regulation has been superseded by changes reflected in P.L. 105-34 and P.L. 99-514, which no longer includes husband and wife as related parties for §1239. The Treasury regulation, however, has not yet been amended.

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Example 8. Annika owns 100% of SkiBoard Corporation. Annika sells a building to SkiBoard for $150,000 in an arm's-length transaction. The building has an adjusted basis to Annika of $100,000. This results in Annika having a $50,000 gain from the sale of the building. Since Annika and SkiBoard are related parties under §1239, the entire $50,000 gain is deemed to be ordinary income.

Example 9. Caden and Addison are twins and each owns 50% of A&C Twins Corporation (Twins). Caden sells a building to Twins for $150,000 in an arm's-length transaction. The building has an adjusted basis to Caden of $100,000, which results in Caden having a $50,000 gain from the sale of the building. Caden's 50% direct ownership plus Addison's 50% indirect ownership of the building is over 50%; therefore, Caden's entire $50,000 gain is deemed to be ordinary income.

Example 10. Use the same facts as **Example 9,** except Caden and Addison are not related in any way. Caden sells Twins a building for $150,000 in an arm's-length transaction. The building has an adjusted basis to Caden of $100,000, which results in Caden having a $50,000 gain from the sale of the building. Since Caden's 50% ownership does not **exceed** 50%, §1239 does **not** apply, and all the gain is capital gain, subject to any §1250 recapture.

INSTALLMENT SALES

Generally, an installment sale permits the seller to spread the income from the sale over the period in which the installment payments are made. There are exceptions such as depreciation recapture and losses, which are generally required to be reported in the year of the sale.

If **depreciable** property is sold to a related person, the sale usually cannot be reported using the installment method. Instead, all payments are considered received in the year of sale. However, the installment method can be used to report a sale of depreciable property to a related person if no significant tax deferral benefit will be derived from the sale. The seller must prove to the satisfaction of the IRS that tax avoidance was not a principal purpose of the sale.[13]

Related parties in this context includes the following:

- A person and all controlled entities with respect to such person;
- A taxpayer and any trust in which the taxpayer (or the taxpayer's spouse) is a beneficiary, unless the beneficiary's interest is a remote contingent interest;
- An executor of an estate and a beneficiary of the estate, except in the case of a sale or exchange in satisfaction of a pecuniary bequest; and
- Two or more partnerships in which the same person owns, directly or indirectly, more than 50% of the capital or profits interests.

RESALES

There is a special rule under IRC §453 that applies when property is sold (first disposition) on the installment method to a related person who then sells, exchanges, or otherwise disposes of the property (second disposition) **within two years** of the first disposition before all payments have been made on the first disposition. In this situation, the lesser of the amount realized on the second disposition or the remaining contract price on the first disposition (or the FMV if the disposed property is not sold or exchanged) is treated as if received at the time of the second disposition.[14]

13. IRS Pub. 537, *Installment Sales* (2008), p. 6.

14. Ibid.

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Example 11. On January 5, 2008, Tracy sold land which was investment property to her brother Tim for $100,000. Tracy's adjusted basis in the land was $60,000, leaving her with a gross profit of $40,000. Her gross profit percentage is 40% (gross profit of $40,000 ÷ contract price of $100,000). The contract requires Tim to pay Tracy $10,000 each year (plus adequate interest) over the next 10 years, with the first payment due January 5, 2008.

Tim made the first payment of $10,000 in January 2008, and Tracy included $4,000 in income for that year ($10,000 × 40%). Tim made the second payment of $10,000 in January 2009 and then sold the land on August 5, 2009, for $110,000 in cash. Since Tim resold the property less than two years after Tracy sold the land to him, Tim must advise Tracy of the resale and the $110,000 selling price. Even though Tracy did not receive more than the second $10,000 payment on the contract from Tim during 2009, she is required to report the remaining $36,000 gain (calculated as follows) on her 2009 tax return as though she received the remaining balance due on the contract during the year.

Lesser of amount realized on second disposition or contract price on first disposition	$100,000
Subtract payments previously made by Tim in 2008 and 2009	(20,000)
Amount treated as received because of second disposition	$ 80,000
Add payment from Tim in 2009	10,000
Total payments treated as received in 2009	$ 90,000
Gross profit %	× 40%
Tracy's installment sale income for 2009	$ 36,000

Tracy does not include any installment sale income on her tax returns for the remaining principal payments she receives from Tim subsequent to 2009 because she already reported the total payments and income from the first disposition on her 2008 and 2009 tax returns.

Example 12. Use the same facts as **Example 11,** except Tim resold the property for $50,000 (due to a market decrease in value). Tracy's gain for 2009 is figured as follows:

Lesser of amount realized on second disposition or contract price on first disposition	$50,000
Subtract payments previously made by Tim in 2008 and 2009	(20,000)
Amount treated as received because of second disposition	$30,000
Add payment from Tim in 2009	10,000
Total payments treated as received in 2009	$40,000
Gross profit %	× 40%
Tracy's installment sale income for 2009	$16,000

The resale by Tim accelerated the recognition of $12,000 in gain to Tracy ($16,000 installment sale income less $4,000 gain to be reported if the second disposition had not taken place). Consequently, when Tracy receives the next three annual installments (in 2010–2012) from Tim, they will not be taxed.[15] Tracy will next have installment sale taxable income from her contract with Tim in 2013.

This acceleration rule does not apply to a second disposition if the related parties can show to the IRS's satisfaction that neither the first nor the second disposition had a principal purpose of tax avoidance. For example, if a creditor of the related person forecloses on the property or the related person declares bankruptcy, the second disposition generally qualifies under the nontax-avoidance exception.

15. IRC §453(e)(5).

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The §453 related-party rules are also subject to the following exceptions:

- Any sale or exchange of stock to the issuing corporation is not treated as a first disposition.
- Involuntary conversions under §1033 — such as by fire, theft, or condemnation — are not treated as second dispositions as long as the first sale was before such casualty.
- Any transfer after the death of either party to a first disposition is not treated as a second disposition.

If the property sold between related parties is a marketable security, the 2-year time limit does not apply. Thus, any resale of marketable securities made prior to the time all the payments on the initial installment sale have been made will result in acceleration of gain recognition under §453.

> **Note.** "Marketable securities" is defined as "any security for which, as of the date of the disposition, there was a market on an established securities market or otherwise."[16] There are very limited circumstances in which publicly-traded property can be reported as an installment sale.

The statute of limitations for assessing a deficiency pertaining to a first disposition does not expire until two years after the IRS is notified of the second disposition by the person making the first disposition. In other words, **if the original seller never notifies the IRS of the second disposition, then the original seller's tax return for the year of the second disposition remains open forever.**[17]

For purposes of this section, a related party includes those found in §§267 and 318.

IMPUTED INTEREST

When property is sold by a taxpayer to a related party, the taxpayer often gives the related party a "deal" by not charging interest or by charging interest at a very low rate compared to what an unrelated party would have to pay. This can require the computation of imputed interest. The following rules apply to all sales and are not unique among related parties, but sales or exchanges between related parties tend to have an inadequate interest rate charged more often than sales between unrelated parties.

IRC §§1274 and 483 provide us with the details and the requirements to impute interest if the interest rate charged is not equal to or more than the test rate (explained below). If §1274 does **not** apply to a sale or exchange, §483 generally does.

IRC §1274 applies to installment contracts issued for the sale or exchange of property if any payment under the instrument is due more than six months from the sale or exchange date and the contract does not provide for adequate stated interest. This interest is called original issue discount (OID) and is reported as interest income over the life of the contract. Instead of identifying sales and exchanges which fall under §1274, the Code lists items it does **not** apply to:

- A sale or exchange for which the total payments (principal and interest) are $250,000 or less
- The sale or exchange of the individual's principal residence
- The sale or exchange of a farm for $1 million or less by an individual, an estate, a testamentary trust, a small business corporation (defined in IRC §1244(c)(3)), or a domestic partnership that meets requirements similar to those of §1244(c)(3)
- Debt instruments which are publicly traded or issued for publicly-traded property
- Certain sales of patents
- Certain land transfers between related parties

16. IRC §453(f)(2).
17. IRC §453(e)(8).

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IRC §483 applies to an installment sale contract that does not provide for an adequate interest rate which is due more than six months after the date of the sale or exchange and is not covered by §1274. Interest imputed under §483 is called "unstated interest" and is reported under the taxpayer's normal method of accounting. IRC §483 does **not** apply to:

- A sale or exchange for which no payments are due more than one year after the date of the sale or exchange, or
- A sale or exchange for $3,000 or less.

Regardless of which Code section applies (§§1274 or 483), if inadequate interest is charged on the contract, the seller must treat part of the installment contract as interest income and reduce the selling price accordingly. If the property is not personal-use property, the buyer must also treat part of the installment contract as interest expense and reduce the purchase price accordingly.

Example 13. Annette owns a piece of land with a $50,000 adjusted basis. In 2009, she sells the land for $100,000 to her brother Eric with no down payment, no interest, and annual payments starting in 2010 for a period of 10 years. The amount of imputed interest over the term of the loan is computed to be $20,000. Annette reports a sale of the land in 2009 for $80,000 ($100,000 total payments less $20,000 of imputed interest). As Annette receives payments, she reports a portion of each as interest and the rest as principal. Her gross profit ratio is 37.5% [($80,000 sales price – $50,000 adjusted basis) ÷ $80,000 sales price]. The net result is that Annette has $30,000 of gain from the sale and $20,000 of interest income. When comparing the capital gains tax rates to the rates applicable to interest income, Annette may be in for a bit of a shock when she learns about the imputed interest rules. Eric, on the other hand, may be pleased to find out he has $20,000 of potentially deductible interest expense and an $80,000 basis in the land, instead of no interest and a $100,000 basis in the land.

THE INTEREST TEST RATES

The test rates are based on the applicable federal rates (AFRs). The Treasury issues AFRs each month in a revenue ruling. The AFRs are provided based on time period (short-term, mid-term, and long-term) and compounding factor (annually, semi-annually, quarterly, and monthly). "Short-term" is defined as a debt instrument with a maturity of three years or less, "mid-term" is defined as a debt instrument with a maturity of more than three years but not more than nine years, and "long-term" means a debt instrument with a maturity of more than nine years.

When a sale or exchange takes place, the test rate is the lowest AFR in effect for any month in the 3-month period ending with the calendar month in which there is a binding written contract for the sale or exchange. Consequently, it is important to review all three months of rates to determine the minimum rate for the testing. Knowing the rates for the relevant 3-month period prior to the closing of the sale or exchange allows the taxpayer to ensure that the contract stipulates an adequate interest charge.

As an example, the rates for the months of April, May, and June 2009 are:

		Annual	Semi-annual	Quarterly	Monthly
April 2009 (Rev. Rul. 2009-10)	Short-term	.83	.83	.83	.83
	Mid-term	2.15	2.14	2.13	2.13
	Long-term	3.67	3.64	3.62	3.61
May 2009 (Rev. Rul. 2009-12)	Short-term	.76	.76	.76	.76
	Mid-term	2.05	2.04	2.03	2.03
	Long-term	3.58	3.55	3.53	3.52
June 2009 (Rev. Rul. 2009-16)	Short-term	.75	.75	.75	.75
	Mid-term	2.25	2.24	2.23	2.23
	Long-term	3.88	3.84	3.82	3.81

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Example 14. During June 2009, Brian sells rental property to Kelly on installment with payments scheduled monthly over 10 years. Since this contract is for more than nine years, it is a long-term contract with monthly compounding. The lowest of the relevant rates for long-term, monthly compounding is 3.52% (lowest of 3.61% (April), 3.52% (May), and 3.81% (June)). Therefore, if the contract does not call for interest at a rate of at least 3.52%, there is unstated interest.

Note. See the *Reference Material* section at the end of this book for a listing of monthly AFRs for October 2007 through September 2009.

In certain situations, the OID test rate is the lower of the AFR or a special minimum rate. For most debt instruments given in consideration for the sale or exchange of property, the special minimum rate is 9%, compounded semiannually, for a principal amount of less than $2.8 million (as indexed for inflation). In the case of land transfers between family members when the aggregate sales price does not exceed $500,000 during the calendar year, the special minimum test rate is 6%, compounded semiannually.[18]

Note. See pages 383–385 of the 2007 *University of Illinois Federal Tax Workbook* for more information on imputed interest and AFRs. This can be found on the accompanying CD.

BELOW-MARKET LOANS

IRC §7872 PROVISIONS

To avoid the imputed-interest rules, the IRC requires an adequate interest rate to be charged on installment sales, as discussed above, and also on loans. IRC §7872 covers the treatment of loans with below-market interest rates. The types of below-market loans between related parties include:

- **Gift loans.** Any below-market loan in which the forgoing of interest is in the nature of a gift within the meaning of Chapter 12 of the Code;
- **Compensation-related loans.** A below-market loan made in connection with the performance of services, directly or indirectly, between an employer and an employee, an independent contractor and a person using the services of the independent contractor, or a partnership and a partner, if the loan is made in consideration for services performed by the partner outside the partner's capacity in the partnership; and
- **Corporation-shareholder loans.** A below-market loan made directly or indirectly between a corporation and any shareholder of the corporation.

In addition to the relationship of the parties, it is important to know if the loan is a term loan or a demand loan when determining the minimum amount of interest that should be charged on the loan:

- A **term loan** is a loan that has a specific term. The minimum market interest rate on a term loan is based on the AFRs as of the time the loan is made. Any imputed interest is deemed to be paid on the loan date, rather than the repayment date.
- A **demand loan** is a loan that is due upon demand. The minimum market interest rate for a demand loan changes twice each year. The AFR used is the one for short-term, semi-annual compounding. The rate in effect for January is used for the outstanding balance from January–June. The rate in effect for July is used for the outstanding balance from July–December. If a demand loan amount remains constant for the entire calendar year, there is a "blended rate" that is issued in July that may be used to calculate the interest for the year. This is calculated by summing the January and July rates and dividing by two. Since interest is considered to be compounded semi-annually, the interest for the January–June period is added to the loan before computing the interest for the period from July–December.

  The imputed interest for a demand loan is deemed to be paid each year on December 31. This makes the imputed interest taxable each year that the loan is open, in essence spreading the imputed interest over the contract's entire life.

[18] IRC §§1274A and 483(e).

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Gift Loans

Forgone interest is the interest which is deemed to accrue in excess of the interest actually charged under the terms of the loan. The forgone interest on gift loans, as on demand loans, is treated as transferred from the lender to the borrower and also retransferred by the borrower to the lender as interest. This retransfer results in interest income for the lender and interest expense for the borrower. The imputed interest is treated as transferred (and retransferred) on December 31 each year.

A de minimis exception to this rule exists for certain gift loans. When the total of all gift loans between individuals does not exceed $10,000 on a given day, interest need not be charged. This exception does not apply to loans attributable to the acquisition of income-producing assets.[19]

Example 15. On January 13, 2009, Everett made a noninterest-bearing gift loan of $7,000 to his son, Dennis. This is the only loan between the two individuals. Since the total is less than $10,000, interest is not required.

Example 16. Use the same facts as **Example 15,** except Everett makes a second noninterest-bearing gift loan to Dennis on March 6, 2009, for an additional $5,000. Since the total of the loans is now more than $10,000, interest is required to be imputed on the total amount of the loans starting March 6, 2009.

Example 17. Use the same facts as **Example 16,** except Dennis makes a repayment of $2,000 on the principal of the loan on July 1, 2009. Since the total of the loans is more than $10,000 starting March 6, 2009 ($7,000 original gift loan + $5,000 second gift loan), and does not exceed $10,000 as of July 1, 2009 ($7,000 + $5,000 – $2,000 repayment of principal), interest is only required to be imputed on these loans for the period starting March 6, 2009, and ending July 1, 2009, when the total of the loan principal was $12,000.

In addition, there is another exception for gift loans between individuals if the loan does not exceed $100,000. In these cases the amount of unstated interest is the smaller of:

1. The normal unstated interest as calculated, or
2. The net investment income received by the borrower during the year.

If the amount of net investment income of the borrower for the year is $1,000 or less, it is treated as zero. If the total amount of loans between a lender and a borrower exceeds $100,000 on any day, this exception does not apply for that day. The purpose of this exception is to permit loans up to $100,000 between individuals without interest as long as the borrower is not using the loans to make investments that produce investment income.

Example 18. Sandy made a $100,000 noninterest-bearing loan to her brother, Billy. There are no other loans between these two individuals. Billy's net investment income for the year is $1,200 and the imputed interest on this loan is $3,000. The unstated interest income that Sandy has to report is $1,200 (the smaller of Billy's $1,200 net investment income or the $3,000 imputed interest).

Example 19. Use the same facts as **Example 18,** except Billy's net investment income for the year is $200. Since the net investment income is $1,000 or less for the year, it is treated as zero. Sandy does not have to report any unstated interest for the year.

When calculating the loan amounts for §7872, it is important to note that husband and wife are considered as one taxpayer. Therefore, loans by either the husband or the wife must be combined to determine if the $10,000 or $100,000 limits are reached.[20]

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19. IRC §7872(c)(2).
20. IRC §7872(f)(7).

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Compensation-Related Loans

In the case of compensation-related loans, the employer is deemed to transfer the forgone interest to the employee as additional compensation, and the employee is deemed to pay interest to the employer. Different rules apply depending on whether the loan is a demand loan or a term loan. For demand loans, the imputed interest payments and deemed transfer of additional compensation are treated as being made annually. With respect to term loans, the lender is treated as transferring the difference between the loan amount and the present value of all future payments under the loan as additional compensation at the time the loan is made. The additional compensation in the form of imputed interest income is reported on Form W-2 as taxable wages, subject to all withholdings and payroll taxes.[21]

A de minimis exception to this rule exists for certain compensation-related loans as long as tax avoidance is not a principal purpose of the loan arrangement. When the total of all compensation-related loans does not exceed $10,000 on a given day, interest is not required to be charged.[22]

Corporation-Shareholder Loans

Because of the nature of the relationship between the corporation and the shareholder, especially in small corporations, the IRS tends to closely scrutinize loan documents to determine if the transactions in question are bona-fide loans or disguised distributions. Factors that the IRS examines in order to determine if the transfer of money is really a loan or a contribution to capital include:

- The extent the lender controls the corporation (ownership of stock by shareholder),
- Documentation (contract) showing the loan's provisions,
- The interest rate,
- Collateral or security for the loan,
- Corporation's or shareholder's financial position and ability to repay the loan,
- Repayment schedule, and
- History of the corporation paying dividends.

As is the case for gift loans and compensation-related loans, a de minimis exception to the below-market interest rate rule exists for corporate-shareholder loans as long as tax avoidance is not a principal purpose of the loan arrangement. When the total of all corporation-shareholder loans does not exceed $10,000 on a given day, interest is not required to be charged.

Loans from Shareholder to Corporation. Shareholders often make loans to their corporations when a need for funds arises. Loans are frequently made instead of capital contributions because loans can be repaid without tax consequences other than the interest involved, while returns on capital contributions are treated as distributions to shareholders. At the corporate level, the interest paid on loans is deductible while the payment of dividends is not.

The amount of imputed interest is considered money given by the shareholder to the corporation as a contribution to capital. This gives the shareholder additional basis in the corporation. If the shareholder receives new shares in exchange for this contribution, the basis is allocated to those new shares. This amount is reported in the capital stock and additional paid-in surplus accounts, just as any other purchase of new shares. If the shareholder does not receive new shares, the basis in the existing shares increases by this amount and is generally reported as additional paid-in capital.

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21. *Executive Compensation — Fringe Benefits Audit Techniques Guide.* February 2005. [www.irs.gov/businesses/corporations/article/0,,id=134943,00.html] Accessed on June 17, 2009.

22. IRC §7872(c)(3).

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The shareholder is then deemed to receive the interest payment from the corporation. This gives the corporation interest expense and the shareholder interest income, which is reportable as interest income on the shareholder's tax return. In the case of a term loan, the imputed interest is considered received on the date the term loan was entered into (or the date the imputed interest rules became effective, if later). In the case of a demand loan, the imputed interest is considered received annually on December 31. If the corporation is an S corporation and the money is used for passive purposes (i.e., the interest is deducted as an expense related to a passive activity), the shareholder deducts the passive activity interest from Schedule B and reports the interest deduction on Schedule E as passive income, which helps offset passive losses.[23]

Loans from Corporation to Shareholder. Corporations sometimes make loans to shareholders instead of paying dividends. This is often done to avoid having the shareholder incur tax on dividend income. If the loans are not properly documented or are not bona-fide loans, the IRS can reclassify the loans as dividends.

When the corporation lends funds to the shareholder, the following transactions are deemed to have taken place:

- The amount of the imputed interest is first considered to be a dividend/distribution payment to the shareholder. If the corporation is a C corporation, the amount is taxable as a dividend to the shareholder under the normal rules (to the extent of the corporation's earnings and profits) and is reported by the corporation on Form 1099-DIV. If the corporation is an S corporation, the imputed interest amount is a distribution reported on Schedule K-1, *Shareholder's Share of Income, Deductions, Credits, etc.*
- Since actual funds in the amount of the imputed interest did not leave the corporation, the shareholder is also deemed to have made a payment of interest to the corporation. This gives the corporation interest income and the shareholder interest expense.

CANCELLATION OF DEBT

IRC §61(a)(12) requires taxpayers to recognize any discharge of indebtedness as income in the year of discharge. A taxpayer could attempt to circumvent this rule by having a related party acquire the debt. Accordingly, the acquisition of debt by a person related to the debtor from a person not related to the debtor results in the realization by the debtor of cancellation of debt income (CODI).[24]

> **Example 20.** Jason owed $100,000 to a local bank. When the bank threatened foreclosure, Jason's father purchased the loan from the bank for $90,000. Jason realizes $10,000 of CODI as a result of his father's purchase.

For this purpose, the related-party definition of family members only includes the taxpayer's spouse, children, grandchildren, parents, and any spouses of the children or grandchildren.[25]

LIKE-KIND EXCHANGES

The provisions of IRC §1031 cover like-kind exchanges. A like-kind exchange permits a taxpayer to trade business or investment property for like-kind property without having to immediately recognize gain or loss. If boot is part of the transaction, some taxable gain may be triggered in the year of the exchange. A tax-deferred exchange results in the postponement of gain or loss until disposal of the property acquired in the exchange. In the case of a gain, this can be advantageous for the taxpayer.

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23. Treas. Reg. §1.469-7.
24. Treas. Reg. §1.108-2(a).
25. IRC §108(e)(4)(C).

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When related parties are involved, there is a special rule that involves the future disposition of the property received in the exchange. For this purpose, "related party" means any person bearing a relationship described in §267(b) (listed on page 280) or §707(b)(1). IRC §707(b)(1) refers to the following relationships:

- A partnership and a person owning, directly or indirectly, more than 50% of the capital interest, or the profits interest, in such partnership
- Two partnerships in which the same persons own, directly or indirectly, more than 50% of the capital or profits interests

TWO-YEAR RULE

The related parties involved in a like-kind exchange must file Form 8824, *Like-Kind Exchanges*, with their tax returns during the year the property was transferred and for the two subsequent years. If either party disposes of the property within two years after the exchange, the exchange is **disqualified from nonrecognition treatment.** The deferred gain or loss from the original exchange must be reported as of the date of the second disposition.

For the year of the exchange, Parts I, II, and III of Form 8824 must be completed. For the two years following the year of the exchange, only Parts I and II must be completed, unless there was a disposition during one of the two years. If a disposition occurred within two years of the exchange, Part III of Form 8824 must be completed, and the amount reported as deferred gain on line 24 is included in income.

If property is disposed of in the same tax year as the like-kind exchange, Form 8824 is not completed; instead, the entire transaction is reported as a sale on Form 4797, *Sales of Business Property.*

Example 21. Travis used a panel truck in his remodeling business. His sister, Tori, used a pickup truck in her landscaping business. On December 15, 2008, Travis exchanged his panel truck plus $200 for Tori's pickup truck. At that time, the FMV of Travis' panel truck was $7,000 and its adjusted basis was $6,000. The FMV of Tori's pickup truck was $7,200 and its adjusted basis was $1,000. Travis realized a gain of $1,000 (the $7,200 FMV of the pickup truck minus the $200 he paid minus the $6,000 adjusted basis of the panel truck). Tori realized a gain of $6,200 (the $7,000 FMV of the panel truck plus the $200 Travis paid minus the $1,000 adjusted basis of the pickup truck).

However, because this was a like-kind exchange, Travis did not recognize any gain. Travis' basis in the pickup truck was $6,200 (the $6,000 adjusted basis of the panel truck plus the $200 he paid). Tori recognized gain only to the extent of the money she received, $200. Her basis in the panel truck was $1,000 (the $1,000 adjusted basis of the pickup truck minus the $200 received plus the $200 gain recognized).

In 2009, Travis sold the pickup truck to a third party for $7,000. He sold it within two years after the exchange; therefore, the exchange is disqualified from nonrecognition treatment. On his 2009 tax return, Travis must report the $1,000 gain on the 2008 exchange. He also reports a loss on the latest sale of $200 ($7,200 adjusted basis of the pickup truck minus the $7,000 realized from the sale).

In addition, Tori must report the $6,000 balance of her gain on the 2008 exchange on her 2009 tax return. Her adjusted basis in the panel truck is increased to $7,000 ($1,000 basis plus $6,000 gain recognized).[26]

Completed 2008 and 2009 Forms 8824 for Travis and Tori follow.

On Tori's 2008 Form 8824, the $200 boot that she recognizes in income in that year is reported on line 23.

On Travis' and Tori's 2009 Forms 8824, the responses to the questions in Part II indicate that there was a sale of property during the year. The amounts reported in Part III of the forms are identical to what was reported in 2008, but because of the sale of Travis' truck, the amounts on lines 24 of both Travis' and Tori's Forms 8824 must be recognized as income in 2009.

26. IRS Pub. 544, *Sales and Other Dispositions of Assets* (2008).

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For Example 21

Form **8824**

Department of the Treasury
Internal Revenue Service

Like-Kind Exchanges
(and section 1043 conflict-of-interest sales)
▶ Attach to your tax return.

OMB No. 1545-1190
2008
Attachment Sequence No. **109**

Name(s) shown on tax return: **Travis**

Identifying number: **222-33-4444**

Part I Information on the Like-Kind Exchange

Note: *If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.*

1 Description of like-kind property given up:
Panel truck

2 Description of like-kind property received:
Pickup truck

3 Date like-kind property given up was originally acquired (month, day, year)	3	01	06	2007
4 Date you actually transferred your property to other party (month, day, year)	4	12	15	2008
5 Date like-kind property you received was identified by written notice to another party (month, day, year). See instructions for 45-day written notice requirement	5	12	15	2008
6 Date you actually received the like-kind property from other party (month, day, year). See instructions	6	12	15	2008

7 Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If "Yes," complete Part II. If "No," go to Part III . . . . ☑ Yes ☐ No

Part II Related Party Exchange Information

8 Name of related party	Relationship to you	Related party's identifying number
Tori	**Sister**	**111-22-3333**

Address (no., street, and apt., room, or suite no., city or town, state, and ZIP code)
45 Parliament Lane, Philadelphia, PA 19101

9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange or transfer property into the exchange, directly or indirectly (such as through an intermediary), that became your replacement property? . . . . ☐ Yes ☑ No

10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? . . . . ☐ Yes ☑ No

If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is ***not*** *the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24* ***unless*** *one of the exceptions on line 11 applies.*

11 If one of the exceptions below applies to the disposition, check the applicable box:

a ☐ The disposition was after the death of either of the related parties.

b ☐ The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.

c ☐ You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. If this box is checked, attach an explanation (see instructions).

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For Example 21

Form 8824 (2008) Page 2

Name(s) shown on tax return. Do not enter name and social security number if shown on other side. | Your social security number

Travis | 222-33-4444

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: *If you transferred* ***and*** *received* ***(a)*** *more than one group of like-kind properties or* ***(b)*** *cash or other (not like-kind) property, see* **Reporting of multi-asset exchanges** *in the instructions.*

Note: *Complete lines 12 through 14* ***only*** *if you gave up property that was not like-kind. Otherwise, go to line 15.*

12	Fair market value (FMV) of other property given up	12		
13	Adjusted basis of other property given up	13		
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale		14	
	Caution: *If the property given up was used previously or partly as a home, see* **Property used as home** *in the instructions.*			
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred (see instructions)		15	
16	FMV of like-kind property you received		16	7,200
17	Add lines 15 and 16		17	7,200
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15 (see instructions)		18	6,200
19	**Realized gain or (loss).** Subtract line 18 from line 17		19	1,000
20	Enter the smaller of line 15 or line 19, but not less than zero		20	0
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16 (see instructions)		21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies (see instructions)		22	0
23	**Recognized gain.** Add lines 21 and 22		23	0
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions		24	1,000
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23		25	6,200

Part IV Deferral of Gain From Section 1043 Conflict-of-Interest Sales

Note: *This part is to be used* ***only*** *by officers or employees of the executive branch of the Federal Government or judicial officers of the Federal Government (including certain spouses, minor or dependent children, and trustees as described in section 1043) for reporting nonrecognition of gain under section 1043 on the sale of property to comply with the conflict-of-interest requirements. This part can be used* ***only*** *if the cost of the replacement property is more than the basis of the divested property.*

26 Enter the number from the upper right corner of your certificate of divestiture. (**Do not** attach a copy of your certificate. Keep the certificate with your records.) ▶ _____ – _____

27 Description of divested property ▶ _____

28 Description of replacement property ▶ _____

29	Date divested property was sold (month, day, year)		29	
30	Sales price of divested property (see instructions)	30		
31	Basis of divested property	31		
32	**Realized gain.** Subtract line 31 from line 30		32	
33	Cost of replacement property purchased within 60 days after date of sale	33		
34	Subtract line 33 from line 30. If zero or less, enter -0-		34	
35	Ordinary income under recapture rules. Enter here and on Form 4797, line 10 (see instructions)		35	
36	Subtract line 35 from line 34. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797 (see instructions)		36	
37	**Deferred gain.** Subtract the sum of lines 35 and 36 from line 32		37	
38	**Basis of replacement property.** Subtract line 37 from line 33		38	

Form 8824 (2008)

8

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For Example 21

Form **8824**
Department of the Treasury
Internal Revenue Service

Like-Kind Exchanges
(and section 1043 conflict-of-interest sales)
▶ Attach to your tax return.

OMB No. 1545-1190
2008
Attachment Sequence No. **109**

Name(s) shown on tax return: **Tori**
Identifying number: **111-22-3333**

Part I Information on the Like-Kind Exchange

Note: *If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.*

1 Description of like-kind property given up:
Pickup truck

2 Description of like-kind property received:
Panel truck

3 Date like-kind property given up was originally acquired (month, day, year)	3	01	09	2005
4 Date you actually transferred your property to other party (month, day, year)	4	12	15	2008
5 Date like-kind property you received was identified by written notice to another party (month, day, year). See instructions for 45-day written notice requirement	5	12	15	2008
6 Date you actually received the like-kind property from other party (month, day, year). See instructions	6	12	15	2008

7 Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If "Yes," complete Part II. If "No," go to Part III . . . . ☑ Yes ☐ No

Part II Related Party Exchange Information

8 Name of related party	Relationship to you	Related party's identifying number
Travis	**Brother**	**222-33-4444**

Address (no., street, and apt., room, or suite no., city or town, state, and ZIP code)
100 Revolutionary Way, Philadelphia, PA 19101

9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange or transfer property into the exchange, directly or indirectly (such as through an intermediary), that became your replacement property? . . . . . ☐ Yes ☑ No

10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? . . . . . ☐ Yes ☑ No

If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is ***not*** *the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24* ***unless*** *one of the exceptions on line 11 applies.*

11 If one of the exceptions below applies to the disposition, check the applicable box:

a ☐ The disposition was after the death of either of the related parties.

b ☐ The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.

c ☐ You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. If this box is checked, attach an explanation (see instructions).

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For Example 21

Form 8824 (2008) Page 2

Name(s) shown on tax return. Do not enter name and social security number if shown on other side. | Your social security number

Tori | 111-22-3333

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: *If you transferred* ***and*** *received* ***(a)*** *more than one group of like-kind properties or* ***(b)*** *cash or other (not like-kind) property, see* **Reporting of multi-asset exchanges** *in the instructions.*

Note: *Complete lines 12 through 14* ***only*** *if you gave up property that was not like-kind. Otherwise, go to line 15.*

12	Fair market value (FMV) of other property given up	12		
13	Adjusted basis of other property given up	13		
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale		14	
	Caution: *If the property given up was used previously or partly as a home, see* **Property used as home** *in the instructions.*			
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred (see instructions)		15	200
16	FMV of like-kind property you received		16	7,000
17	Add lines 15 and 16		17	7,200
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15 (see instructions)		18	1,000
19	**Realized gain or (loss).** Subtract line 18 from line 17		19	6,200
20	Enter the smaller of line 15 or line 19, but not less than zero		20	200
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16 (see instructions)		21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies (see instructions)		22	200
23	**Recognized gain.** Add lines 21 and 22		23	200
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions		24	6,000
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23		25	1,000

Part IV Deferral of Gain From Section 1043 Conflict-of-Interest Sales

Note: *This part is to be used* ***only*** *by officers or employees of the executive branch of the Federal Government or judicial officers of the Federal Government (including certain spouses, minor or dependent children, and trustees as described in section 1043) for reporting nonrecognition of gain under section 1043 on the sale of property to comply with the conflict-of-interest requirements. This part can be used* ***only*** *if the cost of the replacement property is more than the basis of the divested property.*

26	Enter the number from the upper right corner of your certificate of divestiture. (**Do not** attach a copy of your certificate. Keep the certificate with your records.) ▶			
27	Description of divested property ▶			
28	Description of replacement property ▶			
29	Date divested property was sold (month, day, year)		29	
30	Sales price of divested property (see instructions)	30		
31	Basis of divested property	31		
32	**Realized gain.** Subtract line 31 from line 30		32	
33	Cost of replacement property purchased within 60 days after date of sale	33		
34	Subtract line 33 from line 30. If zero or less, enter -0-		34	
35	Ordinary income under recapture rules. Enter here and on Form 4797, line 10 (see instructions)		35	
36	Subtract line 35 from line 34. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797 (see instructions)		36	
37	**Deferred gain.** Subtract the sum of lines 35 and 36 from line 32		37	
38	**Basis of replacement property.** Subtract line 37 from line 33		38	

Form 8824 (2008)

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For Example 21

Form **8824**
Department of the Treasury
Internal Revenue Service

Like-Kind Exchanges
(and section 1043 conflict-of-interest sales)
▶ Attach to your tax return.

OMB No. 1545-1190
2009
Attachment Sequence No. **109**

Name(s) shown on tax return: **Travis**
Identifying number: **222-33-4444**

Draft as of 06/17/2009

Part I Information on the Like-Kind Exchange

Note: *If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.*

1 Description of like-kind property given up:
Panel truck

2 Description of like-kind property received:
Pickup truck

3 Date like-kind property given up was originally acquired (month, day, year)	3	01/06/2007
4 Date you actually transferred your property to other party (month, day, year)	4	12/15/2008
5 Date like-kind property you received was identified by written notice to another party (month, day, year). See instructions for 45-day written notice requirement	5	12/15/2008
6 Date you actually received the like-kind property from other party (month, day, year). See instructions	6	12/15/2008

7 Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If "Yes," complete Part II. If "No," go to Part III . . . . ☑ Yes ☐ No

Part II Related Party Exchange Information

8 Name of related party	Relationship to you	Related party's identifying number
Tori	**Sister**	**111-22-3333**

Address (no., street, and apt., room, or suite no., city or town, state, and ZIP code)
45 Parliament Lane, Philadelphia, PA 19101

9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange or transfer property into the exchange, directly or indirectly (such as through an intermediary), that became your replacement property? . . . . . ☐ Yes ☑ No

10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? . . . . . ☑ Yes ☐ No

If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is ***not*** *the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24* ***unless*** *one of the exceptions on line 11 applies.*

11 If one of the exceptions below applies to the disposition, check the applicable box:

a ☐ The disposition was after the death of either of the related parties.

b ☐ The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.

c ☐ You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. If this box is checked, attach an explanation (see instructions).

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For Example 21

Form 8824 (2009) Page 2

Name(s) shown on tax return. Do not enter name and social security number if shown on other side. | Your social security number

Travis | 222-33-4444

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: *If you transferred* ***and*** *received* ***(a)*** *more than one group of like-kind properties or* ***(b)*** *cash or other (not like-kind) property, see* **Reporting of multi-asset exchanges** *in the instructions.*

Note: *Complete lines 12 through 14* ***only*** *if you gave up property that was not like-kind. Otherwise, go to line 15.*

12	Fair market value (FMV) of other property given up	12			
13	Adjusted basis of other property given up	13			
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale			14	
	Caution: *If the property given up was used previously or partly as a home, see* **Property used as home** *in the instructions.*				
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred (see instructions)			15	
16	FMV of like-kind property you received			16	7,200
17	Add lines 15 and 16			17	7,200
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15 (see instructions)			18	6,200
19	**Realized gain or (loss).** Subtract line 18 from line 17			19	1,000
20	Enter the smaller of line 15 or line 19, but not less than zero			20	0
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16 (see instructions)			21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies (see instructions)			22	0
23	**Recognized gain.** Add lines 21 and 22			23	0
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions			24	1,000
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23			25	6,200

Part IV Deferral of Gain From Section 1043 Conflict-of-Interest Sales

Note: *This part is to be used* ***only*** *by officers or employees of the executive branch of the Federal Government or judicial officers of the Federal Government (including certain spouses, minor or dependent children, and trustees as described in section 1043) for reporting nonrecognition of gain under section 1043 on the sale of property to comply with the conflict-of-interest requirements. This part can be used* ***only*** *if the cost of the replacement property is more than the basis of the divested property.*

26 Enter the number from the upper right corner of your certificate of divestiture. (**Do not** attach a copy of your certificate. Keep the certificate with your records.) ▶ _____ – _____

27 Description of divested property ▶ _____

28 Description of replacement property ▶ _____

29	Date divested property was sold (month, day, year)			29	
30	Sales price of divested property (see instructions)	30			
31	Basis of divested property	31			
32	**Realized gain.** Subtract line 31 from line 30			32	
33	Cost of replacement property purchased within 60 days after date of sale	33			
34	Subtract line 33 from line 30. If zero or less, enter -0-			34	
35	Ordinary income under recapture rules. Enter here and on Form 4797, line 10 (see instructions)			35	
36	Subtract line 35 from line 34. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797 (see instructions)			36	
37	**Deferred gain.** Subtract the sum of lines 35 and 36 from line 32			37	
38	**Basis of replacement property.** Subtract line 37 from line 33			38	

Form **8824** (2009)

Draft as of 06/17/2009

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For Example 21

Form **8824**
Department of the Treasury
Internal Revenue Service

Like-Kind Exchanges
(and section 1043 conflict-of-interest sales)
▶ Attach to your tax return.

OMB No. 1545-1190
2009
Attachment Sequence No. **109**

Name(s) shown on tax return: **Tori**
Identifying number: **111-22-3333**

Draft as of 06/17/2009

Part I Information on the Like-Kind Exchange

Note: *If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.*

1 Description of like-kind property given up:
Pickup truck

2 Description of like-kind property received:
Panel truck

3 Date like-kind property given up was originally acquired (month, day, year)	3	01/09/2005
4 Date you actually transferred your property to other party (month, day, year)	4	12/15/2008
5 Date like-kind property you received was identified by written notice to another party (month, day, year). See instructions for 45-day written notice requirement	5	12/15/2008
6 Date you actually received the like-kind property from other party (month, day, year). See instructions	6	12/15/2008

7 Was the exchange of the property given up or received made with a related party, either directly or indirectly (such as through an intermediary)? See instructions. If "Yes," complete Part II. If "No," go to Part III . . . . ☑ Yes ☐ No

Part II Related Party Exchange Information

8 Name of related party	Relationship to you	Related party's identifying number
Travis	**Brother**	**222-33-4444**

Address (no., street, and apt., room, or suite no., city or town, state, and ZIP code)
100 Revolutionary Way, Philadelphia, PA 19101

9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of any part of the like-kind property received from you (or an intermediary) in the exchange or transfer property into the exchange, directly or indirectly (such as through an intermediary), that became your replacement property? . . . . ☑ Yes ☐ No

10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of any part of the like-kind property you received? . . . . ☐ Yes ☑ No

If both lines 9 and 10 are "No" and this is the year of the exchange, go to Part III. If both lines 9 and 10 are "No" and this is ***not*** *the year of the exchange, stop here. If either line 9 or line 10 is "Yes," complete Part III and report on this year's tax return the deferred gain or (loss) from line 24* ***unless*** *one of the exceptions on line 11 applies.*

11 If one of the exceptions below applies to the disposition, check the applicable box:

a ☐ The disposition was after the death of either of the related parties.

b ☐ The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.

c ☐ You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as one of its principal purposes. If this box is checked, attach an explanation (see instructions).

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For Example 21

Form 8824 (2009) Page 2

Name(s) shown on tax return. Do not enter name and social security number if shown on other side. | Your social security number

Tori | 111-22-3333

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: *If you transferred* ***and*** *received* ***(a)*** *more than one group of like-kind properties or* ***(b)*** *cash or other (not like-kind) property, see* **Reporting of multi-asset exchanges** *in the instructions.*

Note: *Complete lines 12 through 14* ***only*** *if you gave up property that was not like-kind. Otherwise, go to line 15.*

12	Fair market value (FMV) of other property given up	12		
13	Adjusted basis of other property given up	13		
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale		14	

Caution: *If the property given up was used previously or partly as a home, see* **Property used as home** *in the instructions.*

15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred (see instructions)	15	200
16	FMV of like-kind property you received	16	7,000
17	Add lines 15 and 16	17	7,200
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses **not** used on line 15 (see instructions)	18	1,000
19	**Realized gain or (loss).** Subtract line 18 from line 17	19	6,200
20	Enter the smaller of line 15 or line 19, but not less than zero	20	200
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16 (see instructions)	21	
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies (see instructions)	22	200
23	**Recognized gain.** Add lines 21 and 22	23	200
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions	24	6,000
25	**Basis of like-kind property received.** Subtract line 15 from the sum of lines 18 and 23	25	1,000

Part IV Deferral of Gain From Section 1043 Conflict-of-Interest Sales

Note: *This part is to be used* ***only*** *by officers or employees of the executive branch of the Federal Government or judicial officers of the Federal Government (including certain spouses, minor or dependent children, and trustees as described in section 1043) for reporting nonrecognition of gain under section 1043 on the sale of property to comply with the conflict-of-interest requirements. This part can be used* ***only*** *if the cost of the replacement property is more than the basis of the divested property.*

26 Enter the number from the upper right corner of your certificate of divestiture. (**Do not** attach a copy of your certificate. Keep the certificate with your records.) ▶ _____ – _____

27 Description of divested property ▶ _____

28 Description of replacement property ▶ _____

29	Date divested property was sold (month, day, year)		29	
30	Sales price of divested property (see instructions)	30		
31	Basis of divested property	31		
32	**Realized gain.** Subtract line 31 from line 30		32	
33	Cost of replacement property purchased within 60 days after date of sale	33		
34	Subtract line 33 from line 30. If zero or less, enter -0-		34	
35	Ordinary income under recapture rules. Enter here and on Form 4797, line 10 (see instructions)		35	
36	Subtract line 35 from line 34. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797 (see instructions)		36	
37	**Deferred gain.** Subtract the sum of lines 35 and 36 from line 32		37	
38	**Basis of replacement property.** Subtract line 37 from line 33		38	

Form **8824** (2009)

Draft as of 06/17/2009

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HOLDING PERIOD

The 2-year holding period begins on the date of the last transfer of property that was part of the exchange. If the risk of loss on the property is substantially diminished during any period, that period is not counted toward the 2-year holding period. The risk of loss is substantially diminished by any of the following events:

- The holding of a put on the property
- The holding by another person of a right to acquire the property
- A short sale or other transaction

EXCEPTIONS

A disqualifying disposition is not considered to have taken place if any of the following apply:

- The disposition takes place after the death of either related party
- The disposition is due to an involuntary conversion
- When it is established to the satisfaction of the IRS that neither the exchange nor the disposition has a principal purpose of tax avoidance

> **Note.** For a thorough discussion of this topic, see Chapter 4, *Like-Kind Exchanges*, in the 2007 *University of Illinois Federal Tax Workbook*. This can be found on the accompanying CD.

INVOLUNTARY CONVERSIONS

If property is compulsorily or involuntarily converted because of theft, seizure, or threat or imminence of condemnation, no gain is recognized.[27] The replacement property must be similar or related in use to the converted property. Various other rules, including the 2-year rule, must be met to avoid the recognition of gain. In certain cases, another condition is that the replacement property must be acquired from an **unrelated** person.[28]

This applies to a taxpayer who is a corporation, a partnership in which one or more C corporations are partners with more than 50% of the capital or profits interest, or any other taxpayer if the converted property has an aggregate realized gain of more than $100,000.[29]

A related person is one described in §§267(b) or 707(b)(1). If the related person acquired the property from an unrelated person within the normal replacement period, it will qualify as replacement property.

27. IRC §1033(a).
28. IRC §1033(i).
29. IRC §1033(i)(2).

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CONTROLLED GROUP OF CORPORATIONS

There are two different controlled groups of corporations as found in IRC §1563(a). One group is a parent-subsidiary controlled group and the other is a brother-sister controlled group.

PARENT-SUBSIDIARY CONTROLLED GROUP

This is a group of two or more corporations connected through stock ownership with a common parent corporation if :

- At least 80% of the total combined voting power of all classes of stock entitled to vote **or** at least 80% of the total value of shares of all classes of stock of each of the other corporations, except the common parent, is owned by one or more of the other corporations; and
- The common parent corporation owns stock with at least 80% of the total combined voting power of all classes of stock entitled to vote **or** at least 80% of the total value of shares of all classes of stock of at least one of the other corporations excluding stock owned directly by such other corporations.

The parent can have more than one subsidiary, and a subsidiary can be a parent of another corporation.

Consolidated Tax Return

A parent-subsidiary controlled group may be able to make an election to file a consolidated return. A consolidated return can save tax-preparation costs as well as allow the profits of one corporation in the controlled group to be offset against the losses of another corporation in the group. In order to file a consolidated return, a parent-subsidiary controlled group must also meet the definition of being an "affiliated group" as found in IRC §1504(a). Normally, this condition is automatically met given that one of the keys is the parent-subsidiary 80%-ownership test. However, an affiliated group cannot include some corporations, including (but not limited to) the following:

- Corporations exempt from tax as an IRC §501 entity
- Insurance companies subject to taxation under IRC §801
- Regulated investment companies and real estate investment trusts
- Foreign corporations
- S corporations

Related Parties

For purposes of determining whether a corporation is a member of a parent-subsidiary controlled group, stock may be owned directly by the corporation or through one of the following means of constructive ownership: [30]

- **Stock options.** If a person has an option to acquire stock, the stock is considered as owned by that person.
- **Attribution from partnerships.** Stock owned, directly or indirectly, by a partnership is considered as owned by any partner having a 5% or greater interest in either the capital or profits of the partnership.
- **Attribution from estates or trusts.** Stock owned, directly or indirectly, by or for an estate or trust is considered as owned by any beneficiary with a 5% or greater interest in the stock.

30. IRC §1563(d)(1)(B).

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BROTHER-SISTER CONTROLLED GROUP

This is a group of two or more corporations where five or fewer persons (individuals, estates, or trusts) own, directly or indirectly, more than 50% of the combined voting power of all classes of stock of each corporation **or** more than 50% of the total value of all classes of stock of each corporation. When making a calculation to determine if more than 50% is owned, only identical ownership is taken into account. The brother-sister controlled group cannot file a consolidated return.

Example 22. Possible Brother Corporation is owned by Jim (40%), Phillip (20%), Grace (20%), and Angela (20%). Possible Sister Corporation is owned by Jim (35%), Phillip (40%), and Barbara (25%). Since there is a common ownership of more than 50% (actually 55%), Possible Brother Corporation and Possible Sister Corporation are a brother-sister controlled group. The common ownership is determined as follows:

	Possible Brother Corporation	Possible Sister Corporation	Common Ownership
Jim	40%	**35%**	35%
Phillip	**20%**	40%	20%
Grace	20%	0%	0%
Angela	20%	0%	0%
Barbara	0%	25%	0%
Total	100%	100%	55%

Example 23. Use the same facts as **Example 22,** except Jim and Grace's ownership percentages in Possible Brother Corporation are reversed. Possible Brother Corporation and Possible Sister Corporation are **not** a brother-sister controlled group. The common ownership is determined as follows:

	Possible Brother Corporation	Possible Sister Corporation	Common Ownership
Jim	**20%**	35%	20%
Phillip	**20%**	40%	20%
Grace	40%	0%	0%
Angela	20%	0%	0%
Barbara	0%	25%	0%
Total	100%	100%	40%

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Related Parties

For purposes of determining whether a corporation is a member of a brother-sister controlled group, stock may be owned directly by an individual, estate, or trust or through one of the following means of constructive ownership:[31]

- **Stock options.** If a person has an option to acquire stock, the stock is considered as owned by that person.
- **Attribution from partnerships.** Stock owned, directly or indirectly, by a partnership is considered as owned by any partner having a 5% or greater interest in either the capital or profits of the partnership.
- **Attribution from estates or trusts.** Stock owned, directly or indirectly, by or for an estate or trust shall be considered as owned by any beneficiary with a 5% or greater interest in the stock.
- **Attribution from corporations.** Stock owned, directly or indirectly, by a corporation is considered as owned by any person who owns 5% or more of its value in stock.
- **Spouse.** An individual is considered as owning stock in a corporation owned, directly or indirectly, by the individual's spouse.
- **Children, grandchildren, parents, and grandparents.**
    - **Minor children.** An individual is considered to own stock which is owned, directly or indirectly, by the individual's children under the age of 21 years.
    - **Adult children and grandchildren.** An individual who owns more than 50% of the total combined voting power of all classes of stock entitled to vote or more than 50% of the total value of shares of all classes of stock in a corporation is considered as owning the stock in the corporation owned, directly or indirectly, by the individual's parents, grandparents, grandchildren, and children who have attained age 21.

RELATED PARTY CONSEQUENCES FOR CONTROLLED GROUPS

In the past, taxpayers sometimes created multiple corporations in order to use the same tax benefits repeatedly. This practice was halted when Congress created IRC §1561 in 1964. This Code section puts limits on various tax benefits which may be used by each controlled group of corporations. The IRS divides the benefits equally among the component members of the group unless they have an apportionment plan providing for unequal allocation. Each member of the controlled group must file Form 1120, Schedule O, *Consent Plan and Apportionment Schedule for a Controlled Group,* to report the apportionment plan in effect. This form must be filed for each tax year that the corporation is a member of a controlled group, even if no apportionment plan is in effect.

31. IRC §1563(d)(2)(B).

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SCHEDULE O (Form 1120)
(Rev. December 2009)
Department of the Treasury
Internal Revenue Service

Consent Plan and Apportionment Schedule for a Controlled Group

► Attach to Form 1120, 1120-C, 1120-F, 1120-FSC, 1120-L, 1120-PC, 1120-REIT, or 1120-RIC.
► See separate instructions.

OMB No. 1545-0123

Name | Employer identification number

Draft as of 06/26/2009

Part I Apportionment Plan Information

1 Type of controlled group:
- a ☐ Parent-subsidiary group
- b ☐ Brother-sister group
- c ☐ Combined group
- d ☐ Life insurance companies only

2 This corporation has been a member of this group:
- a ☐ For the entire year.
- b ☐ From _____, 20_____, until _____, 20_____.

3 This corporation consents and represents to:
- a ☐ Adopt an apportionment plan. All the other members of this group are adopting an apportionment plan effective for the current tax year which ends on _____, 20_____, and for all succeeding tax years.
- b ☐ Amend the current apportionment plan. All the other members of this group are currently amending a previously adopted plan, which was in effect for the tax year ending _____, 20_____, and for all succeeding tax years.
- c ☐ Terminate the current apportionment plan and not adopt a new plan. All the other members of this group are not adopting an apportionment plan.
- d ☐ Terminate the current apportionment plan and adopt a new plan. All the other members of this group are adopting an apportionment plan effective for the current tax year which ends on _____, 20_____, and for all succeeding tax years.

4 If you checked box 3c or 3d above, check the applicable box below to indicate if the termination of the current apportionment plan was:
- a ☐ Voluntary
- b ☐ Involuntary

5 If you did not check a box on line 3 above, check the applicable box below concerning the status of the group's apportionment plan (see instructions).
- a ☐ No apportionment plan is in effect and none is being adopted.
- b ☐ An apportionment plan is already in effect. It was adopted for the tax year ending _____, 20_____, and for all succeeding tax years.

6 If all the members of this group are adopting a plan or amending the current plan for a tax year after the due date (including extensions) of the tax return for this corporation, is there at least one year remaining on the statute of limitations from the date this corporation filed its amended return for such tax year for assessing any resulting deficiency? See instructions.
- a ☐ Yes.
  - *(i)* ☐ The statute of limitations for this year will expire on _____, 20_____.
  - *(ii)* ☐ On _____, 20_____, this corporation entered into an agreement with the Internal Revenue Service to extend the statute of limitations for purposes of assessment until _____, 20_____.
- b ☐ No. The members may not adopt or amend an apportionment plan.

7 Required information and elections under section 1561. Check the applicable box(es) (see instructions).
- a ☐ The corporation will determine its tax liability by applying the maximum tax rate under section 11 to the entire amount of its taxable income.
- b ☐ The corporation and the other members of the group elect the FIFO method (rather than defaulting to the proportionate method) for allocating the group's section 11(b)(1) additional tax.
- c ☐ The corporation has a short tax year that does not include December 31.

For Privacy Act and Paperwork Reduction Act Notice, see Instructions for Form 1120. Cat. No. 48100N **Schedule O (Form 1120) (Rev. 12-2009)**

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Part II **Taxable Income Apportionment** (See instructions)

Caution: *Each total in Part II, column (g) for each component member must agree with Form 1120, page 1, line 30 or the comparable line of such member's tax return.*

(a) Group member's name and employer identification number	(b) Tax year end (Yr-Mo)	Taxable Income Amount Allocated to Each Bracket				
		(c) 15%	(d) 25%	(e) 34%	(f) 35%	(g) **Total** (add columns (c) through (f))
1						
2						

Schedule O (Form 1120) (Rev. 12-2009) Page **3**

Part III **Income Tax Apportionment** (See instructions)

(a) Group member's name	Income Tax Apportionment						
	(b) 15%	(c) 25%	(d) 34%	(e) 35%	(f) 5%	(g) 3%	(h) **Total income tax** (combine lines (b) through (g))
1							
2							

Schedule O (Form 1120) (Rev. 12-2009) Page **4**

Part IV **Other Apportionments** (See instructions)

(a) Group member's name	Other Apportionments				
	(b) Accumulated earnings credit	(c) AMT exemption amount	(d) Phaseout of AMT exemption amount	(e) Penalty for failure to pay estimated tax	(f) Other
1					
2					

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Tax Bracket Apportionment

Each controlled group of corporations is allowed no more than $50,000 of taxable income taxed at the 15% rate, no more than $25,000 of taxable income in excess of $50,000 taxed at the 25% tax rate, and no more than $25,000 of taxable income in excess of $75,000 taxed at the 34% tax rate. This can be split up according to the group's apportionment plan.

> **Example 24.** Lexi Corp. and Seyota Corp. are both owned 100% by the same individual, Marcus. This makes them a brother-sister controlled group. Lexi has a net profit for the year of $40,000 and Seyota has a net loss for the tax year of $40,000. Without an apportionment plan, the limit applied to each of the graduated tax brackets is divided equally among the members of a controlled group. This means that Lexi is taxed on $25,000 of taxable income at the 15% tax rate, and the remaining $15,000 of taxable income at the 25% rate. This is a waste of the other $25,000 of the 15% tax bracket. If the controlled group adopts an apportionment plan which allocates all of the 15% tax bracket to Lexi, then all $40,000 of its income is taxed at 15% and Seyota has none (since Seyota has a net loss for the taxable year), saving the taxpayer $1,500.

An apportionment plan can be changed each year.

Accumulated Earnings Credit

Each controlled group is permitted to have one accumulated earnings credit of $250,000 ($150,000 for certain service corporations). Without an apportionment plan, this credit amount is spread among all the corporations equally.

Alternative Minimum Tax

The rules pertaining to the AMT provide corporations with a $40,000 exemption. Without an apportionment plan, this exemption is divided equally among the component members of the controlled group.

Environmental Tax

The environmental tax applies when the corporation alternative minimum taxable income exceeds $2 million. This $2 million can also be allocated in the apportionment plan.

IRC §179 Limitations

For purposes of applying the limits on expensing property under §179, all component members of a controlled group are treated as one taxpayer.[32] The limit for 2008 and 2009 is $250,000 of qualifying purchases, with a phaseout effective when qualifying purchases for the tax year total $800,000. An apportionment plan can be used to allocate the limits among the controlled group.

A controlled group under §179 is defined differently from the descriptions set forth earlier in this chapter. The phrase **"more than 50%" is substituted for the phrase "at least 80%,"** thereby including more corporations in the controlled group category.

> **Example 25.** Gassco Corporation and Windco Corporation are the only two members of a controlled group. In 2009, Gassco purchased and placed in service $150,000 of qualifying purchases and Windco Corporation purchased and placed in service $100,000 of qualifying purchases. Without an apportionment plan, each corporation has a $125,000 ceiling of §179 expense allowed, since the $250,000 limit is divided equally between the two corporations. Consequently, Gassco would not be able to expense $25,000 ($150,000 total purchases minus $125,000 limit) of its qualifying purchases under §179. Fortunately, Gassco and Windco can make an apportionment plan that allocates the §179 expense $150,000 to Gassco and $100,000 to Windco for the 2009 taxable year.

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32. IRC §179(d)(6).

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REDEMPTION OF STOCK IN A FAMILY CORPORATION

The ownership of stock in a closely-held corporation by related family members complicates the tax treatment of corporate stock redemptions.

A distribution in redemption of corporate stock can be treated either as a sale of stock or as a dividend.[33] For the redemption to be treated as a sale of stock, IRC §302(b)(2) requires that the redemption be substantially disproportionate. A substantially-disproportionate redemption under §302(b)(2) requires that after the redemption:

1. The shareholder owns less than 50% of the voting stock, and
2. The shareholder reduces his percentage of ownership of stock by more than 20%.

The above requirements must be met after taking into account the family attribution rules under §318. The reductions in stock ownership required under §302(b)(2) can be difficult to achieve under the family attribution rules when the closely-held corporation is owned by various family members. In a family-owned corporation, each family member is generally deemed to own the other family member's shares. For purposes of §318, family members having constructive ownership include spouses, parents, and lineal descendants (not siblings).

Under §302(c)(2), the family attribution rules will be deemed waived if, during the shareholder's life, the shareholder:

1. Completely terminates the shareholder's ownership interest (other than as a creditor),
2. Does not acquire any interest in the corporation for 10 years,
3. Files the appropriate agreements with the IRS, and
4. Meets all other requirements of IRC §302(c)(2).

Complying with the waiver of family-attribution rules is the only way for a family-owned corporation to have a substantially-disproportionate redemption of stock treated as a sale of stock.

If a shareholder dies owning closely-held corporation stock, and that stock is held in an entity such as an estate or trust, the entity can only waive the attribution by complying with IRC §302(c)(2)(C). This requires **both** the entity and each related person after the redemption to:

1. Have no interest in the redeeming corporation (other than as a creditor),
2. Acquire no interest in the redeeming corporation for 10 years, and
3. File the appropriate agreements with the IRS.

33. IRC §302(b).

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WASH SALES

Wash sales are covered by IRC §1091. Although §1091 has no explicit related-party rule, there are court cases that apply the related-party rules of §267. These cases disallow losses on wash-sale transactions because of the "dominion and control" exercised by the taxpayer.[34]

Example 26. Jim and Pam are married. Jim sold 500 shares of Bank of America stock at a loss on December 1, 2009. On the same day, Jim directed Pam's broker to purchase 500 shares of Bank of America stock. Jim should not be allowed to deduct the loss because he exercised "dominion and control" over the purchase of shares by his wife.

BONUS DEPRECIATION

Bonus depreciation falls under IRC §168(k) and has been resurrected for qualifying purchases in calendar years 2008 and 2009. Qualifying purchases include new equipment and machinery and certain leasehold improvements. Congress put a restriction in place that denies bonus depreciation on property subject to a binding written contract prior to January 1, 2008.

To prevent taxpayers with binding contracts from having a related party make the purchase of property, Congress also included a provision in the law that disqualifies property when "the user of such property (as of the date on which such property is originally placed in service) or a person which is related (within the meaning of §§267(b) or 707(b)) to such user or to the taxpayer had a written binding contract in effect for the acquisition of such property at any time on or before December 31, 2007."[35]

Bonus depreciation for leasehold improvements is also denied if the lease agreement is between related parties. For this purpose, a related party is defined in §267(b), modified to raise the ownership percentage from the **"more than 50%" test to an "80% or more" test.**

The leasehold-improvement provision also includes any affiliated groups as defined in IRC §1504 as related parties, which includes a corporation that is at least 80% owned by the parent corporation. This affiliated group does not include certain corporations such as those exempt from tax under IRC §501 and S corporations.

Example 27. Kurt owns 100% of Plainview Corporation. Kurt owns a building that he leases to Plainview. All of the normal conditions for leasehold improvements are met; however, neither Kurt nor Plainview can claim bonus depreciation on any leasehold improvements related to this lease due to the related-party limitations.

Example 28. Use the same facts as **Example 27,** except Kurt and an unrelated party each own 50% of Plainview. In this case the related party rules do **not** apply since the ownership is not "80% or more."

Example 29. Grahm-Crunch Corporation owns 100% of Smore Corporation. This makes Grahm-Crunch a parent corporation and Smore a subsidiary corporation. Smore owns a building and leases it to Grahm-Crunch. All of the normal conditions for leasehold improvements are met. Neither Grahm-Crunch nor Smore can claim bonus depreciation on any leasehold improvements related to this lease due to the related-party limitations.

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34. *Mitchell Est. v. Comm'r,* 37 B.T.A. 161 (1938); *McWilliams v. Comm'r,* 331 U.S. 694 (1947).

35. IRC §168(k)(2)(E)(iv)(I).

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IRC §179 (EXPENSING)

The year personal property is purchased and placed in service in a business activity, the taxpayer has an election available under IRC §179 to expense the costs instead of depreciating the asset over time. As mentioned previously, the limit for 2008 and 2009 is $250,000 of qualifying purchases, with a dollar-for-dollar phaseout when qualifying purchases for the tax year total $800,000.

Congress imposed a restriction in §179(d)(2) for purchases by related parties. The restriction states that property purchased from a related party is not eligible for §179 expensing. In this context, a related party is generally defined as that found in §§267 and 707(b), except that the relevant family members include only the taxpayer's spouse, ancestors, and lineal descendants. It does **not** include the taxpayer's brothers and sisters. Consequently, qualifying property purchased from siblings can be expensed under §179.

Property acquired by a component member of a controlled group from another member of the same controlled group is also not eligible for §179 expensing. This eliminates purchases between brother-sister corporations and parent-subsidiary corporations.

Other property that is not eligible for the §179 election includes any property that has an adjusted basis to the taxpayer that is tied to the adjusted basis of the property in the hands of the person from whom it was acquired. This includes property which is acquired by gift or part gift/part sale. Inherited property is also not eligible for the §179 election.

RETIREMENT PLANS

Taxpayers generally must take required minimum distributions (RMDs) from their retirement accounts, including employer-sponsored retirement accounts and individual retirement accounts (IRAs), starting with the year the taxpayer reaches age 70½. There is a special provision that permits the first year's distribution to be delayed until April 1 of the year following the year in which the taxpayer attains the age of 70½.

Some employee-sponsored retirement plans allow participants to defer taking RMDs until the later of the year the participant reaches age 70½ or the year in which the participant retires from the employer that maintains the account. Accordingly, as long as an employee continues to work for the employer, the employee is not required to take RMDs from the employer's retirement account. This option is not available for traditional IRAs.

However, any taxpayer who owns more than 5% of the company is not permitted to take advantage of this delayed RMD provision. This group includes any taxpayer who owns more than 5% of the outstanding stock of a corporation or more than 5% of the capital or profits interest in the employer.

Example 30. Amy works full-time for Work Forever Corporation and is a nonowner. Amy reaches age 70½ during 2010 but continues to work until 2015. She is not required to take an RMD from Work Forever Corporation's retirement plan until the year 2015.

Example 31. Use the same facts as **Example 30,** except Amy owns more than 5% of Work Forever Corporation. Amy is required to begin taking RMDs no later than April 1, 2011.

Note. See Chapter 9, Retirement, in this workbook for more information about RMDs, including the 2009 waiver that is available.

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PARTNERSHIP INCOME AND LOSSES

PARTNERSHIP INTERESTS OWNED BY MINORS

In some situations, a child is given an interest in a partnership with the intent of saving some tax dollars by having a portion of the income taxed at the child's tax rates instead of the parent's tax rates. The effectiveness of this strategy for tax-avoidance purposes is limited by the kiddie tax rules which apply to taxpayers who are age 18 or under and full-time students between the ages of 19 and 23 if they do not provide more than half of their support with earned income. Net unearned income of children subject to the kiddie tax rules is generally taxed at the parents' highest marginal rate.

When it comes to a partnership interest owned by a minor child, Treas. Reg. §1.704-1(e)(2)(viii) states a minor is **not** deemed a partner unless the minor can be shown to be competent to handle his own property and participate in the partnership's activities. If the minor is not competent to handle his own affairs, the control of the minor's ownership can be exercised by another person as a fiduciary for the sole benefit of the minor. If the child's ownership or income from the ownership is used for the child's support for which a parent is legally responsible, the ownership could be ruled to be the parent's. The fiduciary must also fulfill all legal requirements of such position, including any necessary court filings.

GIFTS OF PARTNERSHIP INTERESTS

IRC §704(e)(1) states that a person is recognized as a partner in a partnership if he owns a capital interest in a partnership when capital is a material income-producing factor, regardless of whether the capital was derived by purchase or a gift from another person. Capital is a material income-producing factor when a substantial portion of the partnership's gross income is attributable to the employment of capital as opposed to the personal services of the members or employees. However, if a partnership interest was received as a gift, the partnership is first required to allocate a portion of its income to the donor partner to the extent of reasonable compensation for services that donor provided to the partnership if the donor partner has not already been compensated for such services. Additionally, the remaining partnership income is divided proportionate to the donor's and donee's respective interests in the partnership capital.[36]

> **Example 32.** Roxanne is the managing partner of Cerano Partnership, in which she has a 90% capital interest and her daughter, Hannah, has a 10% interest. Hannah's interest in the partnership was a gift from Roxanne. The partnership agreement stipulates that partnership income is to be split equally between Roxanne and Hannah with no allowance made for compensation for Roxanne's services. Despite the terms of the partnership agreement, Roxanne must be reasonably compensated for her services, after which the remaining partnership income must be split 90% to Roxanne and 10% to Hannah, in proportion to their capital interests.

Observation. This is known as the economic effect rule.

Treas. Reg. §1.704-1(e)(1)(iii) states "Transactions between members of a family will be closely scrutinized, and the circumstances, not only at the time of the purported transfer but also during the periods preceding and following it, will be taken into consideration in determining the bona fides or lack of bona fides of the purported gift or sale. A partnership may be recognized for income purposes as to some partners but not as to others." This regulation addresses the recognition or nonrecognition of a partnership interest when it is received by gift. The IRS examines the control over the partnership interest using the facts and circumstances test. If the donor retains ownership based on facts and circumstances, the donor is considered the true owner of that partnership interest.

36. IRC §704(e)(2).

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Legal documentation showing the transfer of the partnership interest is a factor the IRS examines to determine if a transfer indeed took place, although such a document is not determinative by itself. Additional issues that are considered include:

- Participation in management,
- Actual distributions received,
- Whether the taxpayer is held out to the public as a partner in the conduct of the business, and
- The partner's existence on legal documents, such as bank accounts, written agreements, and insurance policies.

The more ways it appears the taxpayer is indeed a partner, the more likely it is that the IRS will agree.

TRUSTS

Trusts also fall under the related-party provisions of §267 with respect to losses, expenses, and interest expense. The following trust participants are considered related:

1. A grantor and a fiduciary of the trust
2. The fiduciaries of each trust, if two or more trusts have the same grantor
3. The beneficiary and the fiduciary of the trust
4. A beneficiary of one trust and the fiduciary of another trust, if two or more trusts have the same grantor
5. A corporation with 50% or more of the stock owned, directly or indirectly, by the grantor or the trust and the trust fiduciary

Example 33. The Smith Trust owns 50% of the stock of Jones Corp. as well as several parcels of land. A land sale between the Smith Trust fiduciary and Jones Corp. is covered by §267. However, a land sale between Smith Trust and Jones Corp. is not covered.

Note. While a transaction between the fiduciary and the corporation is covered by §267, a transaction between the trust and the corporation is not covered.

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ESTATE TAX PROVISIONS

For estate tax purposes, property is generally valued at FMV, which takes into account the property's "highest and best" use. However, IRC §2032A provides an alternative valuation method which may be used, under certain conditions, by an executor to value qualified real property used for farming or in a closely-held business on the basis of the property's actual use instead of valuing it based on its "highest and best" use. This rule often means a substantial reduction in estate taxes, which may encourage heirs to continue using the property for farming or small business purposes instead of selling the property to pay estate taxes. All of the following conditions must be met to elect the special-use valuation:

- The decedent was a citizen or resident of the United States at the time of death.
- The real property is located in the United States.
- The real property was passed from the decedent to a qualified heir.
- The real property was used for farming or in a nonfarm trade or business by the decedent or a member of the decedent's family.
- During at least five of the last eight years ending at the decedent's death, the real property was owned by the decedent or a member of the decedent's family and was used for farming or in a nonfarm trade or business.
- There was material participation by the decedent or a member of the decedent's family in the farm or business operation during at least five of the last eight years ending at the decedent's death. The 8-year testing period also may end at the time the taxpayer becomes disabled or beings receiving social security benefits.

> **Note.** A decedent, prior to death, is permitted to rent qualified property to a family member on a net cash basis. Additionally, a decedent, prior to death, may lease real property to a separate business. This separate business must be closely held with respect to the decedent, with no more than 15 family members owning and operating the business. Such lease periods count towards the decedent's pre-death qualified-use period.

- Fifty percent or more of the gross estate's adjusted value consists of **real or personal** property which was being used for farming or in a nonfarm trade or business.
- Twenty-five percent or more of the adjusted value of the gross estate consists of qualified **real** property.

RELATED PARTIES

For purposes of §2032A, a "qualified heir" for any property is defined as a member of the decedent's family who acquired such property, or to whom such property passed, from the decedent. This definition refers to the following members of the decedent's family:[37]

1. Ancestors
2. Spouse
3. Lineal descendants of the decedent or of the decedent's spouse or of the decedent's parents
4. The spouse of a lineal descendant mentioned in number 3

LIMITATION ON FMV REDUCTION

For a decedent dying in 2009, the aggregate decrease in the value of qualified real property permitted under the special-use valuation method of §2032A cannot exceed $1 million.

37. IRC §2032A(e)(2).

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PER DIEMS

GENERAL RULES

The IRS has the authority to permit taxpayers to claim a deduction for some expenses on a per diem basis instead of requiring the use of actual expenses. The IRS allows the use of per diems for lodging and meal expenses in certain circumstances.

A meal expense per diem can be used for business travel away from home that involves a necessary rest period (i.e., generally an overnight trip). The meal expense per diem can be at or below the government rate, as found on **www.gsa.gov** under the heading of "Per Diem Rates." For fiscal year 2009, the meal per diem ranges from $39 to $64. The applicable amount depends on where the taxpayer stops for sleep or rest during the travel away from home. This amount can be claimed as a deduction by a sole proprietor or an unreimbursed employee. It can also be used by an employer who provides an employee a reimbursement of meal expenses or an advance for meal expenses. Any amount of meal per diem provided to employees that is equal to or less than the applicable governmental rate is deductible by the employer (subject to the normal meal reduction) and is not taxable to employees. Employees and self-employed individuals are only allowed to deduct actual expenses for lodging.

A lodging expense per diem can also be used for business travel away from home that involves a necessary rest period. The lodging expense per diem can be at or below the government rate as found on **www.gsa.gov,** which varies by locality. This lodging amount is somewhat different from the meal per diem in that the lodging per diem **can only be used** by an employer who is giving an employee a reimbursement of lodging expenses or an advance for lodging expenses. Any amount of lodging per diem provided to employees that is equal to or less than the applicable governmental rate is deductible by the employer and is not taxable to employees.

Annually, the IRS releases a revenue procedure which contains special provisions. One section lists the special meal per diem available to taxpayers in the transportation industry. This revenue procedure also provides a high/low method of calculating a per diem that includes lodging and meals. Travel per diem allowances in certain designated localities may be reimbursed at the high rate and travel per diems in all other areas must be paid at the low rate. Any amount of high/low per diem provided to employees that is equal to or less than the applicable governmental rate is deductible by the employer (subject to the normal meal reduction) and is not taxable to employees.

RELATED-PARTY RULES

The IRS limits the use of per diems when it comes to reimbursement or advances to related parties. Currently the **meal** per diem can be used for everyone, including related parties. However, the **lodging** per diem and the **high/low** per diems cannot be provided to employees who fall into the related party category. "Related parties" for this purpose include anyone who owns, directly or indirectly, 10% or more of the business.[38]

This effectively denies the tax benefit of being able to use any per diem that includes lodging. If a per diem that includes lodging is provided to a related party, the full per diem reimbursement or advance must be included in the employee's compensation and is therefore subject to tax withholdings and applicable payroll taxes. The full amount is deductible by the employer and included in the employee's wages. The employee can claim actual expenses incurred as unreimbursed employee business expenses using the proper forms (i.e., Form 2106, *Employee Business Expenses,* and Form 1040, Schedule A) on her personal tax return.[39]

> **Observation.** To achieve a better tax result under related-party situations, the employer should establish an accountable reimbursement plan making expenses paid by the employer deductible and reimbursements to the employee nontaxable.

38. See IRC §267(b); the 50% ownership percentage mentioned in §267(b)(2) drops to 10%. See Rev. Proc. 2008-59.

39. Several years ago, the meal and lodging per diems were both subject to this restriction. See Rev. Proc. 2008-59, 2008-41 IRB (Oct. 14, 2008).

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SUMMARY OF IRC §267 RELATED PARTIES

IRC §267 **denies losses** between a person and the following related parties:

- An individual and his:
  - Lineal descendant
  - Ancestor
  - Sibling
  - Spouse
  - Adopted child
- A shareholder and a more than 50% owned corporation
- A corporation and a more than 50% shareholder
- A corporation and:
  - A 50% subsidiary corporation
  - A 50% parent corporation
  - Another corporation if five or fewer shareholders control 50% or more of both corporations
  - Another member of corporate seller's combined groups
  - A partnership if the same person owns 50% or more of each
- An S corporation and another S corporation if the same persons own more than 50% of each
- An S corporation and a C corporation if the same persons own more than 50% of each
- A grantor and fiduciary of a trust
- Fiduciaries of two trusts with the same grantor
- A fiduciary and beneficiary of a trust
- A fiduciary of one trust and beneficiary of another trust if they have the same grantor
- A fiduciary and corporation owned more than 50% by the trust
- A executor of an estate and a beneficiary of the same estate
- A partnership and:
  - A more than 50% partner
  - Another partnership if same persons own more than 50% of each[40]

IRC §267 **does not** apply to losses between a person and:

- His stepmother,
- His stepfather, or
- His child of a stepparent by previous marriage.

Caution. There may be exceptions to these relationships in certain instances.

40. Transactions under IRC §707(b) by reference fall under the loss provisions of §267.

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