

or gifts, in connection with the performance by him of services for his client or customer, under a reimbursement or other expense allowance arrangement with his client or customer, and includes amounts charged directly or indirectly to the client or customer through credit card systems or otherwise. See paragraph (h) of this section relating to the substantiation of meal expenses while traveling.

(2) *Substantiation by independent contractors.* An independent contractor shall substantiate, with respect to his reimbursements, each element of an expenditure (described in paragraph (b) of this section) in accordance with the requirements of paragraph (c) of this section; and, to the extent he does not so substantiate, he shall include such reimbursements in income. An independent contractor shall so substantiate a reimbursement for entertainment regardless of whether he accounts (within the meaning of subparagraph (3) of this paragraph) for such entertainment.

(3) *Accounting to a client or customer under section 274(e)(4)(B).* Section 274(e)(4)(B) provides that section 274(a) (relating to disallowance of expenses for entertainment) shall not apply to expenditures for entertainment for which an independent contractor has been reimbursed if the independent contractor accounts to his client or customer to the extent provided by section 274(d). For purposes of section 274(e)(4)(B), an independent contractor shall be considered to account to his client or customer for an expense paid or incurred under a reimbursement or other expense allowance arrangement with his client or customer if, with respect to such expense for entertainment, he submits to his client or customer adequate records or other sufficient evidence conforming to the requirements of paragraph (c) of this section.

(4) *Substantiation by client or customer.* A client or customer shall not be required to substantiate, in accordance with the requirements of paragraph (c) of this section, reimbursements to an independent contractor for travel and gifts, or for entertainment unless the independent contractor has accounted to him (within the meaning of section

274(e)(4)(B) and subparagraph (3) of this paragraph) for such entertainment. If an independent contractor has so accounted to a client or customer for entertainment, the client or customer shall substantiate each element of the expenditure (as described in paragraph (b) of this section) in accordance with the requirements of paragraph (c) of this section.

(h) *Authority for an optional method of computing meal expenses while traveling.* The Commissioner may establish a method under which a taxpayer may elect to use a specified amount or amounts for meals while traveling in lieu of substantiating the actual cost of meals. The taxpayer would not be relieved of substantiating the actual cost of other travel expenses as well as the time, place, and business purpose of the travel. See paragraph (b)(2) and (c) of this section.

(i) *Effective date—(1) In general.* Section 274(d) and this section apply with respect to taxable years ending after December 31, 1962, but only with respect to period after that date.

(2) *Certain meal expenses.* Paragraph (h) of this section is effective for expenses paid or incurred after December 31, 1982.

[T.D. 6630, 27 FR 12931, Dec. 29, 1972, as amended by T.D. 7226, 37 FR 26711, Dec. 15, 1972; T.D. 7909, 48 FR 40370, Sept. 7, 1983; 48 FR 41017, Sept. 13, 1983; T.D. 8051, 50 FR 36576, Sept. 9, 1985. Redesignated by T.D. 8715, 62 FR 13990, Mar. 25, 1997; T.D. 8996, 67 FR 35008, May 17, 2002]

TERMINAL RAILROAD CORPORATIONS AND THEIR SHAREHOLDERS

§ 1.281-1 In general.

Section 281 provides special rules for the computation of the taxable incomes of a terminal railroad corporation and its shareholders when the terminal railroad corporation, as a result of taking related terminal income into account, reduces a charge which was made or which would be made for related terminal services furnished to a railroad corporation. Section 281 and paragraphs (a) and (b) of § 1.281-2 provide that the “reduced amount” described in paragraph (c) of § 1.281-2 is not includable in gross income of the terminal railroad corporation, is not

treated as a dividend or other distribution to its railroad shareholders, and is not treated as an amount paid -or incurred by the railroad shareholders to the terminal railroad corporation. Section 281 and paragraph (a)(2) of §1.281-2 provide that no deduction otherwise allowable to a terminal railroad corporation shall be disallowed as a result of the "reduced amount" described in paragraph (c) of §1.281-2. Section 1.281-3 defines the terms *terminal railroad corporation*, *related terminal income*, *related terminal services*, *agreement*, and *railroad corporation*. Section 1.281-4 describes the effective dates and special rules for application of section 281 to taxable years ending before October 23, 1962.

[T.D. 7356, 40 FR 23732, June 2, 1975]

§ 1.281-2 Effect of section 281 upon the computation of taxable income.

(a) *Computation of taxable income of terminal railroad corporations*—(1) *Income not considered received or accrued.* A terminal railroad corporation (as defined in paragraph (a) of §1.281-3) shall not be considered to have received or accrued the "reduced amount" described in paragraph (c) of this section in the computation of its taxable income. Thus, income is not to be considered accrued or actually or constructively received by a terminal railroad corporation where, in the manner described in paragraph (c) of this section, (i) a charge which would be made to any railroad corporation for related terminal services is not made, or (ii) a portion of any liability payable by any railroad corporation with respect to related terminal services is discharged.

(2) *Deduction not disallowed.* In the computation of the taxable income of a terminal railroad corporation, a deduction relating to a "reduced amount", described in paragraph (c) of this section, which is otherwise allowable to it under chapter 1 of the Code (without regard to sec. 277) shall not be disallowed by reason of section 281. Thus, deductions for expenses attributable to services rendered to a shareholder are not to be disallowed to a terminal railroad corporation merely because, in the manner described in paragraph (c) of this section, (i) a charge which would be made to any railroad corporation for related terminal services is not

made, or (ii) a portion of any liability payable by any railroad corporation with respect to related terminal services is discharged. To the extent that section 281 applies to a deduction relating to a "reduced amount", such deduction shall not be disallowed under section 277.

(b) *Computation of taxable income of shareholders*—(1) *Income not considered received or accrued.* A shareholder of a terminal railroad corporation shall not be considered to have received or accrued any "reduced amount" (described in paragraph (c) of this section) in the computation of the shareholder's taxable income. Thus a dividend is not to be considered actually or constructively received by a shareholder of a terminal railroad corporation merely because, in the manner described in paragraph (c) of this section, (i) a charge which would be made to the shareholder or any other railroad corporation for related terminal services is not made, or (ii) a portion of any liability payable by it or any other railroad corporation with respect to related terminal services is discharged.

(2) *Expenses not considered paid or incurred.* In the computation of the taxable income of a shareholder of a terminal railroad corporation, the shareholder shall not be considered to have paid or incurred any "reduced amount" (described in paragraph (c) of this section). Thus, a shareholder of the terminal railroad corporation may not deduct as an expense for related terminal services (as defined in paragraph (c) of §1.281-3) an amount in excess of the net cost to it of such services.

(c) *Amounts to which section 281 applies*—(1) *Reduced amount.* For purposes of this section, the term *reduced amount* means, subject to the limitation of paragraph (c)(4) of this section, the amount by which:

(i) A charge which would be made by a terminal railroad corporation for its taxable year for related terminal services provided to a railroad corporation; or

(ii) A liability of a railroad corporation, resulting from a charge made by a terminal railroad corporation for its taxable year, with respect to related terminal services provided by the terminal railroad corporation, is reduced

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by reason of the terminal railroad corporation's taking into account, pursuant to an agreement (as defined in paragraph (d) of § 1.281-3), related terminal income (as defined in paragraph (b) of § 1.281-3) received or accrued (without regard to section 281) during such taxable year.

(2) *Charge which would be made.* For purposes of this section, a "charge which would be made" by a terminal railroad corporation is the amount that would be charged to any railroad corporation for related terminal services provided if the terminal railroad corporation made the charge without taking related terminal income into account.

(3) *Reduction resulting from related terminal income.* For purposes of subparagraph (1) of this section, a charge or a liability is reduced by taking related terminal income into account to the extent that:

(i) Related terminal income is received or accrued (without regard to section 281) by the terminal railroad corporation for its taxable year in which the charge or liability is reduced; and

(ii) The charge or liability in question would have been larger than it is had such income not been received or accrued (without regard to section 281). The reduction must be made (directly or indirectly) on the books of the terminal railroad corporation, and in fact, for the same taxable year for which the charge would be made or for which the liability is incurred. The reduction of the charge or liability must be taken into account by the terminal railroad corporation in ascertaining the income, profit, or loss for such taxable year for the purpose of reports to shareholders and the Interstate Commerce Commission, and for credit purposes.

(4) *Limitation.* To the extent that a reduced amount (as described in paragraph (c)(1) of this section but without regard to the limitation under this subparagraph) would operate either to create or to increase a net operating loss for the terminal railroad corporation, this section shall not apply. Therefore, if a portion of a liability is discharged (in the manner described in this paragraph) and the discharged portion of

the liability exceeds an amount equal to the terminal railroad corporation's gross income minus the deductions allowed by chapter 1 of the Code (computed with regard to the modifications specified in section 172(d) but without regard to section 281 and this section), then section 281 and this section shall not apply to such excess. The limitation described in this subparagraph shall apply only to taxable years of terminal railroad corporations ending after October 23, 1962.

(d) *Examples.* The provisions of this section may be illustrated by the following examples. In these examples, references to "before the application of section 281", "after the application of section 281", "taxable income", and "allowable deductions" take no account of section 277, which may apply to deductions to which section 281 does not apply.

Example 1. (i) *Facts.* The T Company is a terminal railroad corporation which charges its three equal shareholders, the X, Y, and Z railroad corporations, a rental calculated monthly on a wheelage or user basis for the use of its services and facilities. The T Company and each of its shareholders report income on the calendar year basis. A written lease agreement to which all of the shareholders were parties was entered into in 1947. The agreement provides that at the end of each year the liabilities of each of the shareholders resulting from charges for rental obligations with respect to related terminal services shall be reduced by the shareholder's one-third share of the net income from each source of revenue that produced income (computed before reduction for Federal income taxes). For the calendar year 1973, the T Company's charges to its shareholders include the following charges for related terminal services: \$35,000 to the X Company, \$25,000 to the Y Company, and \$20,000 to the Z Company. Thus, prior to reduction, total shareholder liabilities to the T Company for related terminal services are \$80,000 at the end of 1973. The T Company's net income from all sources (before reduction of liabilities pursuant to the 1947 agreement and before reduction for Federal income taxes) and its taxable income, before the application of section 281, for 1973 are \$36,000 determined as follows:

Source	Gross income	Allowable deductions	Income (or loss)
Related terminal services performed:			
For shareholders	\$80,000	\$65,000	\$15,000
For nonshareholders	46,000	37,000	9,000

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Source	Gross income	Allowable deductions	Income (or loss)
Related terminal income	126,000	102,000	24,000
Nonrelated terminal income	30,000	18,000	12,000
Total	156,000	120,000	36,000

The liability of each shareholder is, pursuant to the agreement, discharged in part by the T Company crediting \$12,000 against the rental due from each shareholder for a total discharge of liabilities of \$36,000 (the net income from all sources), resulting in net shareholder liabilities owing to the T Company at the end of 1973 of \$44,000 (\$80,000 less \$36,000): \$23,000 from the X Company, \$13,000 from the Y Company, and \$8,000 from the Z Company.

(ii) *Effect on terminal railroad corporation.* The reduced amount to which this section applies is \$24,000 (related terminal income of \$9,000 from nonshareholders and \$15,000 from shareholders). Thus, to the extent of \$24,000, the T Company is not considered to have received or accrued income from the discharged liabilities of \$36,000. Similarly, to the extent of the same \$24,000, the T Company is not disallowed deductions for expenses merely by reason of the discharge. The T Company's taxable income for 1973 after application of section 281 is \$12,000, computed as follows:

Gross income (\$156,000 less \$24,000)	\$132,000
Less allowable deductions	120,000
Taxable income	12,000

(iii) *Effect on shareholders*—The reduced amount of \$24,000 shall not be deemed to constitute either a dividend to the shareholders of the T Company or an expense paid or incurred by them. Thus, under the facts described, neither the X Company, the Y Company, nor the Z Company shall be considered to have received or accrued a dividend of \$8,000, or to have paid or incurred an expense of \$8,000. Assuming the X Company's taxable income for 1973 before the application of section 281 would have been \$43,200, computed in the following manner, its taxable income for 1973 after the application of section 281 is \$50,000, determined as follows:

	Before the application of sec. 281	After the application of sec. 281
Gross income:		
From sources other than T Co ..	\$146,000	\$146,000
Dividend considered received because of T Co.'s discharge of liabilities of \$12,000	12,000	4,000
Total	158,000	150,000
Less allowable deductions:		
From sources other than T Co ..	69,600	69,600

	Before the application of sec. 281	After the application of sec. 281
85 percent dividend received deduction under sec. 243 attributable to dividend considered received because of T Co.'s discharge of liabilities	10,200	3,400
Expenses for accrued charges for related terminal services performed by T Co	35,000	27,000
	114,800	100,000
Taxable income	43,200	50,000

Example 2. Assume the same facts as in *Example 1*, except that the charges to each of the shareholders for related terminal services for 1973 were as follows: \$35,000 to the X Company, \$40,000 to the Y Company, and \$5,000 to the Z Company. Assume further that the Z Company, prior to the reduction in liabilities at the end of 1973, owed the T Company an additional \$4,000 resulting from charges for 1972 for related terminal services and \$6,000 resulting from the purchase of equipment. Since only \$21,000 (X Company \$8,000, Y Company \$8,000, Z Company \$5,000) of the liabilities which were discharged resulted from charges made for 1973 for related terminal services, the reduced amount to which this section applies is \$21,000 (instead of \$24,000 as in *Example 1*). Thus, the T Company's taxable income for 1973 would be \$15,000 (\$36,000 less \$21,000 reduced amount) and the amount which shall be considered not to have been received or accrued as a dividend nor paid or incurred as an expense of each shareholder is \$8,000 for the X Company, \$8,000 for the Y Company, and \$5,000 for the Z Company.

Example 3. Assume the same facts as in *Example 1*, except that the allowable deductions with respect to nonrelated terminal activities were \$39,000 instead of \$18,000. The T Company's net income from all sources (before reduction for Federal income taxes) and its taxable income, before the application of section 281, is therefore \$15,000, determined as follows:

Source	Gross income	Allowable deductions	Income (or loss)
Related terminal income	\$126,000	\$102,000	\$24,000
Nonrelated terminal income	30,000	39,000	(9,000)
Total	156,000	141,000	15,000

The liability of each shareholder is nevertheless discharged in part, pursuant to the agreement, by the T Company crediting \$8,000 against the rental due from each shareholder for a total discharge of liabilities of \$24,000 (the net income from each

source of revenue that produced income). Assume further that none of the modifications specified in section 172(d) apply. If the limitation under paragraph (c)(4) of this section were not applied, the reduced amount for the purposes of this section would be \$24,000, and the operation of this section would result in a net operating loss of \$9,000, since the allowable deductions of \$141,000 would exceed the gross income of \$132,000 (\$156,000 less discharged liabilities of \$24,000) by that amount. Because of the limitation under paragraph (c)(4) of this section, however, \$9,000 is not included in the reduced amount to which this section applies. Accordingly, the reduced amount is \$15,000 (instead of \$24,000 as in *Example 1*). Thus, the T Company's taxable income for 1973 would be zero (\$15,000 less the \$15,000 reduced amount), and the amount which each shareholder shall be considered not to have received or accrued as a dividend nor paid or incurred as an expense is \$5,000.

Example 4. Assume the same facts as in *Example 1*, except that under the agreement income from the terminal parking lot would not reduce the shareholders' liabilities. Assume further that such income amounted to \$3,000 of the total related terminal income of \$24,000 for the taxable year 1973. The liability of each shareholder therefore is discharged by crediting \$11,000 against its rental due for a total discharge of liabilities of \$33,000. The reduced amount to which this section applies is \$21,000 (\$24,000 less \$3,000) since only to the extent of \$21,000 would there have been no such reduction under the agreement if there were no related terminal income.

Example 5. Assume the same facts as in *Example 1*, except that, pursuant to the agreement, the A Company, a nonshareholder railroad corporation, is to have its liabilities resulting from charges for rental obligations reduced equally with each of the shareholders. Assume further that the T Company's charges to the A Company for the calendar year 1973 included \$15,000 for related terminal services and that the liability of each shareholder and the A Company is discharged in part pursuant to the agreement by the T Company crediting \$9,000 against the rental due from each. The reduced amount to which this section applies is \$24,000. Thus, the T Company's taxable income for 1973 is \$12,000, and each shareholder shall not be considered to have received or accrued as a dividend nor paid or incurred as an expense \$6,000 (\$24,000/36,000 × \$9,000) merely because of the discharge of its own liability. Similarly, each shareholder shall not be considered to have received or accrued as a dividend nor paid or incurred as an expense \$2,000 (1/3 × (\$24,000/36,000 × \$9,000)) merely because of the discharge of the liability of the A Company. Section 281 does not apply to the determination of the tax consequences of the transaction to the A Company. Similarly, the section does not apply to the de-

termination of the tax consequences to the shareholders resulting from that portion of the discharge of the liability of the A Company which is attributable to the application of income which is not related terminal income (\$3,000). Hence, such consequences shall be determined under the sections of the Internal Revenue Code which govern in the absence of section 281.

Example 6. (i) *Facts.* The TR Company is a terminal railroad corporation with three equal shareholders, the M, N, and O Railroad Corporations. The TR Company and each of its shareholders report income on the calendar year basis. Pursuant to a written agreement entered into in 1947 to which all shareholders were parties, the TR Company makes one annual charge to each of the three shareholders at the end of each year for the difference between the cost of operations, allocated on a wheelage or user basis for the use of its services and facilities provided to the shareholder during the year, and one-third of its net income from all other sources (computed before reduction for Federal income taxes). The TR Company's taxable income, before the application of section 281, for 1973 is \$21,000 determined as follows:

Source	Gross income	Allowable deductions	Income (or loss)
Related terminal services performed:			
For shareholders ..	\$65,000	\$65,000	0
For nonshareholders	46,000	37,000	\$9,000
Related terminal income	111,000	102,000	9,000
Nonrelated terminal income from nonshareholders	30,000	18,000	12,000
Total	141,000	120,000	21,000

For the calendar year 1973, the TR company's charges to its shareholders are \$23,000 (\$30,000 less \$7,000) to the M company, \$13,000 (\$20,000 less \$7,000) to the N company, and \$8,000 (\$15,000 less \$7,000) to the O company for a total of \$44,000 for related terminal services.

(ii) *Effect on terminal railroad corporation.* The reduced amount to which this section applies is \$9,000. The TR company is not considered to have received or accrued income of \$9,000 (related terminal income) merely because the charge of \$21,000 (net income from all sources other than shareholders) was not made. Similarly, to the extent of \$9,000, the TR company is not disallowed deductions for expenses merely because the full cost of services was not charged. The TR company's taxable income for 1973 after application of section 281, is \$12,000, computed as follows:

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Gross income (\$141,000 less \$9,000 charges not made)	\$132,000
Less allowable deductions	120,000
Taxable income	12,000

(iii) *Effect on shareholders.* Neither the M company, the N company, nor the O company shall be considered to have received or accrued a dividend of \$3,000 nor to have paid or incurred an expense of \$3,000 merely by reason of the reduced charges. Thus, assuming the M company's taxable income for 1973 before the application of section 281 would have been \$47,450, computed in the following manner, its taxable income for 1973 after the application of section 281 is \$50,000, determined as follows:

	Before the applica- tion of sec. 281	After the applica- tion of sec. 281
Gross income:		
From sources other than TR Co	\$146,000	\$146,000
Dividend considered received because of TR Co.'s reduction of charges	7,000	4,000
Total	153,000	150,000
Less allowable deductions:		
From sources other than TR Co	69,600	69,600
85 percent dividend received deduction under sec. 243 attributable to dividend considered received because of TR Co.'s reduction of charges	5,950	3,400
Expenses for accrued charges for related terminal services performed by TR Co	30,000	27,000
Total	105,550	100,000
Taxable income	47,450	50,000

[T.D. 7356, 40 FR 23733, June 2, 1975]

§ 1.281-3 Definitions.

(a) *Terminal railroad corporation.* The term *terminal railroad corporation* means a corporation which, in the taxable year, meets all of the following conditions:

(1) The corporation and each of its shareholders must be domestic corporations. Thus, all of the shareholders of the corporation, as well as the corporation itself, must be corporations which were organized or created in the United States, including only the States and the District of Columbia, or under the law of the United States or of any State or territory.

(2) All of the shareholders must be railroad corporations which are subject to Part I of the Interstate Commerce

Act. Thus, if any shareholder of the corporation, regardless of the class or percentage of stock owned, is not subject to the jurisdiction of the Interstate Commerce Commission under part I of that Act, the corporation cannot qualify as a terminal railroad corporation.

(3) The corporation must not be a member of an affiliated group of corporations (as defined in section 1504), other than as a common parent corporation. For this purpose it is immaterial whether or not the affiliated group has ever made a consolidated income tax return. Thus, if the X railroad corporation owns 80 percent of all of the outstanding stock of the Y railroad corporation, the X railroad corporation may qualify, but the Y railroad corporation cannot qualify, as a terminal railroad corporation.

(4) The primary business of the corporation must be that of providing to domestic railroad corporations subject to Part I of the Interstate Commerce Act and to the shippers and passengers of such railroad corporations one or more of the following facilities or services: (i) Railroad terminal facilities, (ii) railroad switching facilities, (iii) railroad terminal services, or (iv) railroad switching services. The designated facilities and services include the furnishing of terminal trackage, the operation of stockyards or a union passenger or freight station, and the operation of railroad bridges and ferries. The providing of the designated facilities includes the leasing of those facilities. A corporation shall be considered as having established that its primary business is that of providing the designated facilities and services if more than 50 percent of its gross income (computed without regard to section 281, and excluding dividends and gains and losses from the disposition of capital assets or property described in section 1231(b)) for the taxable year is derived from those sources. The fact that income from a service or facility is included within the definition of related terminal income is immaterial for purposes of determining whether that service or facility is one which is designated in this subparagraph. Thus, although income from the operation of a commuter railroad line may be related

terminal income, a corporation whose primary business is the operation of that facility is not a terminal railroad corporation, since its primary business is not the providing of the designated facilities or services.

(5) A substantial part of the services rendered by the corporation for the taxable year must be rendered to one or more of its shareholders. For purposes of this requirement, providing the use of facilities shall be considered the rendering of services.

(6) Each shareholder of the corporation must compute its taxable income on the basis of a taxable year which either begins or ends on the same day as the taxable year of the corporation.

(b) *Related terminal income*—(1) *In general.* Related terminal income is, generally, the type of income normally earned from the operation of a railroad terminal. The term *related terminal income* means the taxable income (computed without regard to sections 172, 277, or 281) which the terminal railroad corporation derives for the taxable year from the sources enumerated in paragraph (b)(2) of this section. Related terminal income must be derived from direct provision of the specified facilities or services by the terminal corporation itself. Thus, income consisting of rent from a lease of a terminal facility by a terminal corporation to a railroad user would qualify; but dividends from a corporation in which the terminal corporation owned stock and which provided such facilities or services to others would not qualify. The term does not include gain or loss derived from the sale, exchange, or other disposition of capital assets or section 1231 assets, whether or not section 1245 or section 1250 applies to part or all of that gain. For example, the term does not apply to gain from the sale of a terminal building or terminal equipment. All direct and indirect expenses and other deductible items attributable to related terminal services or facilities shall be deducted in determining related terminal income. Attribution shall be determined in accordance with customary railroad accounting practices accepted by the Interstate Commerce Commission, except that interest paid with respect to the indebtedness of a terminal railroad

corporation shall be deducted from related terminal income to the extent that the proceeds from the indebtedness were directly or indirectly applied to facilities or activities producing such income. The district director may either accept the use of the taxpayer's method of determining the application of the proceeds of all indebtedness of such corporation or prescribe the use of another method which, under all the facts and circumstances, appears to reflect more accurately the probable application of such proceeds.

(2) *Sources of related terminal income.* The term *related terminal income* includes only income derived from one or more of the following sources:

(i) From services or facilities of a character ordinarily and regularly provided by terminal railroad corporations for railroad corporations or for the employees, passengers, or shippers of railroad corporations. Whether the services or facilities are of a character ordinarily and regularly provided by terminal railroad corporations is to be determined by accepted industry practice. The fact that nonterminal businesses may also provide such services or facilities is immaterial. However, there must be a direct relationship between the service or facility provided and the operation of the terminal, including the operation of its trackage and switching facilities. Thus, the term *related terminal income* includes income derived from operating or leasing switching facilities and terminal facilities, such as income from charges to railroad corporations for the use of a union passenger or freight station. Also included for this purpose is income derived from charges to railroad shippers, including express companies and freight forwarders, for the use of sheds or warehouses, even though not directly intended for railroad use. The term includes income derived from leasing or operating restaurants, drugstores, barbershops, newsstands, ticket agencies, banking facilities, car rental facilities, or other similar facilities for passengers, in waiting rooms or along passenger concourses. Similarly, the term includes income derived from operating or leasing passenger parking facilities, and from renting taxicab space, located on or adjacent to the

terminal premises. Although the term does include income derived from the operation of a small hotel operated primarily for and usually occupied primarily by the employees of the railroad corporations, it does not include income derived from the operation of a hotel for passengers or other persons.

(ii) From any railroad corporation for services or facilities provided by the terminal railroad corporation in connection with railroad operations. A service or a facility is provided in connection with railroad operations if it is of a character ordinarily and regularly availed of by railroad corporations. For purposes of this subdivision, the income must be derived from railroad corporations. Thus, in addition to the income derived from sources described in paragraph (b)(2)(i) of this section, the term *related terminal income* includes income derived from switching facilities or leasing to any railroad corporation, or operating for the benefit of such corporation, a beltline or bypass railroad leading to or from the terminal premises. Also included are income derived from the rental of office space (whether or not services are provided to the occupants) in the terminal building to any railroad corporation for that corporation's administrative or operating divisions, and income derived from tolls charged to any railroad corporation for the use of a railroad bridge or ferry.

(iii) From the use by persons other than railroad corporations of a portion of a facility, or of a service, which is used primarily for railroad purposes. A facility or service is used primarily for railroad purposes if the predominant reason for its continued operation or provision is the furnishing of facilities or services described in either subdivision (i) or (ii) of this subparagraph. The determination required by this subdivision is to be made independently for each separate facility or service. Two substantial portions of a single structure may be considered separate facilities, depending upon the respective uses made of each. Moreover, any substantial addition, constructed after October 23, 1962, to a facility shall be considered a separate facility.

The term *related terminal income* includes income produced by operating a

commuter service or by renting tracks and facilities for a commuter service to an independent operator. The term also includes the sale or rental of advertising space at a terminal facility. If the conditions described in this subdivision are satisfied, the term *related terminal income* may include income which has no connection with the operation of the terminal. Thus, if a terminal railroad corporation operates a railroad bridge primarily to provide railroad corporations a means of crossing a river and the lower level of the bridge contains a roadway for similar use by automobiles, the term includes income derived from the tolls charged to the automobiles for the use of the bridge roadway. However, upon the discontinuance of operations of the railroad level of the bridge, the term would cease to include the automobile tolls. If excess steam from a steam plant operated primarily to supply steam to the terminal is sold to another business in the neighborhood, the term would include the income derived from such sale. However, because an oil or gas well or a mine constitutes a separate facility, the term *related terminal income* does not include income derived in any form from a deposit of oil, natural gas, or any other mineral located on property owned or leased by the terminal railroad corporation.

Similarly, while the term includes income derived from the rental of a small number of offices located in the terminal building (whether or not the lessees are railroad corporations), it does not include income derived from the leasing or operation, for the use of the general public, of a large number of offices or a large number of rooms for lodging, whether or not the space is physically part of the same structure as the terminal. Moreover, the term does not include income derived from the rental of offices to the general public in an addition to the terminal building constructed after October 23, 1962, unless the addition is primarily used for railroad purposes and the offices rented to the general public do not constitute a separate facility in the addition. Whether or not income from the addition is determined to be related terminal income, the income from the

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small number of offices which were included in the terminal building before the addition was constructed shall continue to be related terminal income.

(iv) From the United States in payment for facilities or services in connection with mail handling. The income must be derived directly from the U.S. Government, or any agency thereof (including for this purpose the U.S. Postal Service), through the receipt of payments for mail-handling facilities or services. Thus, the term would include income derived from the rental of space for a post office for use by the general public on the terminal premises or from the sorting of mail in a railroad box car.

(3) *Illustration.* The provisions of this paragraph may be illustrated by the following example:

Example. For its calendar year 1973, the R Company, a terminal railroad corporation, has taxable income of \$36,000, before the application of section 281 and taking no account of section 277, determined as follows:

Gross income:	
Switching charges	\$50,000
Express companies	2,000
Commuter line	4,000
U.S. mail handling	4,000
Railroad bridge tolls:	
From railroads	2,000
From automobiles	1,000
Total	3,000
Station and train charges	47,000
Terminal parking lot	4,000
Rent from terminal building:	
Passenger facilities (ground level)	8,000
Offices leased to railroads (2d floor)	3,000
Offices leased to others (2d floor)	1,000
Hotel open to public (3d through 6th floors)	14,000
Total	26,000
Interest received from bond investments	1,500
Dividends received from wholly owned subsidiary	10,000
Amount realized from sale of equipment	6,000
Less:	
Adjusted basis	1,000
Expenses of sale	500
	<u>1,500</u>
	4,500
	<u>156,000</u>
Allowable deductions:	
Dividend received deduction	8,500
Interest paid:	
On loan for hotel furnishings	1,500
On loan for rolling stock	2,000
	<u>3,500</u>
Maintenance, depreciation, management and other expenses:	
Attributable to hotel	3,000
Attributable to parking lot	1,000

Attributable to U.S. mail handling	1,000
All other	98,000
	<u>103,000</u>
Loss from sale of securities	3,000
Charitable contribution	500
Net operating loss deduction	1,500
	<u>120,000</u>
Taxable income before the application of sec. 281	36,000
The R Co.'s related terminal income for 1973 is \$24,000, computed as follows:	
Taxable income (before the application of sec. 281)	36,000
Less:	
Dividend received	10,000
Minus dividend received deduction	8,500
	<u>1,500</u>
Interest received	1,500
Amount realized from sale of equipment	6,000
Less:	
Adjusted basis	1,000
Expense of sale	500
	<u>1,500</u>
	4,500
Hotel income	14,000
Less:	
Interest paid on loan for hotel	1,500
Other hotel expenses	3,000
	<u>4,500</u>
	9,500
	<u>17,000</u>
	19,000
Add:	
Loss from sale of securities	3,000
Charitable contribution	500
Net operating loss deduction	1,500
	<u>5,000</u>
Related terminal income	24,000

(c) *Related terminal services.* The term *related terminal services* means only the services or the use of facilities, provided by the terminal railroad corporation, which are taken into account in computing related terminal income. Thus, the term includes the providing of terminal and switching services, the furnishing of terminal and switching facilities including the furnishing of terminal trackage, and the operation of bridges and ferries for railroad purposes. For example, upon the facts of the example in the preceding paragraph, the charges for related terminal services are \$126,000, determined as follows:

Switching charges	\$50,000
Express companies	2,000
Commuter line	4,000

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U.S. mail handling	4,000
Railroad bridge tolls	3,000
Station and train charges	47,000
Terminal parking lot	4,000
Rent from:	
Passenger facilities	8,000
Offices	4,000
Total	126,000

(d) *Agreement.* As used in section 281 and §1.281-2 the term *agreement* means a written contract, entered into before the beginning of the terminal railroad corporation's taxable year in question, to which all shareholders of the terminal railroad corporation are parties. The fact that other railroad corporations or persons are also parties will not disqualify an agreement. Section 281 applies only if, and to the extent that, the reduction of the liability or charge that would be made, as described in paragraph (c) of §1.281-2, results from the agreement. Thus, where the other conditions of the statute are met, section 281 applies if a written agreement, to which all of the shareholders were parties and which was entered into prior to the beginning of the terminal railroad corporation's taxable year, provides that the net revenues of the terminal railroad corporation are to be applied as a reduction of what would otherwise be the charge for the taxable year for related terminal services provided to the shareholders. Similarly, section 281 applies, where its other requirements are fulfilled, if the agreement provides that the net revenues are to be credited against rental obligations resulting from related terminal services furnished to shareholders. However, section 281 does not apply where the agreement provides that the net revenues are to be divided among the shareholders and distributed to them in cash or held subject to their unconditional right of withdrawal instead of being applied to the computation of charges, or in reduction of liabilities incurred, for related terminal services.

(e) *Railroad corporation.* For purposes of section 281, §1.281-2, and this section, the term *railroad corporation* means any corporation (regardless of whether it is a shareholder of the terminal railroad corporation) that is engaged as a common carrier in the furnishing or sale of transportation by railroad, or is a lessor of railroad equipment or facilities.

For purposes of the preceding sentence, a corporation is a lessor of railroad equipment or facilities only if (1) it is subject to part I of the Interstate Commerce Act, (2) substantially all of its railroad properties have been leased to a railroad corporation or corporations, (3) each lease is for a term of more than 20 years, and (4) 80 percent or more of its gross income for the taxable year is derived for such leases.

[T.D. 7356, 40 FR 23735, June 2, 1975]

§ 1.281-4 Taxable years affected.

(a) *In general.* Except as provided in paragraph (b) of this section, the provisions of section 281 and §§1.281-2 and 1.281-3 shall apply to all taxable years to which either the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939 apply.

(b) *Taxable years ending before October 23, 1962.* (1)(i) In the case of a taxable year of a terminal railroad corporation ending before October 23, 1962, section 281 (a) shall apply only to the extent that the terminal railroad corporation (a) computed its taxable income on its return for such taxable year as if the "reduced amount", described in paragraph (c) of §1.281-2, were not received or accrued, and (b) did not decrease its otherwise allowable deductions for such taxable year on account of that "reduced amount". Similarly, in the case of a taxable year of a shareholder of a terminal railroad corporation ending before October 23, 1962, section 281(b) shall apply only to the extent that such shareholder computed its taxable income on its return for such taxable year as if the shareholder had neither received or accrued as a dividend nor paid or incurred as an expense the "reduced amount" described in paragraph (c) of §1.281-2. Such return must have been filed on or before the due date (including the period of any extension of time) for filing the return for the applicable taxable year. The fact that an amended return or claim for refund or credit of overpayment was subsequently filed, or a deficiency subsequently assessed, based upon a computation of taxable income which is inconsistent with the manner in which the taxable income was computed on the timely filed return, is immaterial.

(ii) The provisions of this paragraph may be illustrated by the following examples:

Example 1. The G Company is a terminal railroad corporation which in 1960 reduced the liabilities resulting from charges to its shareholders, pursuant to a 1947 written agreement, by its income from nonshareholder sources. For the calendar year 1960, the G Company's related terminal income was \$24,000, of which \$3,000 is attributable to income from the United States in payment for facilities and services in connection with mail handling. Although the shareholders' liabilities were reduced by \$24,000 as a result of taking related terminal income earned during the taxable year into account, on its timely filed 1960 income tax return the G Company treated the \$3,000 of liabilities which were reduced on account of income from mail handling as gross income received or accrued during the year. Assuming that the provisions of § 1.281-2 otherwise apply, their application to the determination of the 1960 tax liability of the G Company shall not extend to the entire "reduced amount" of \$24,000, but shall be limited to \$21,000 of that amount.

Example 2. Assume the same facts as in *Example 1*, and the following additional facts. The G Company had three shareholders in 1960, and an equal discharge of liability of \$8,000 resulted for each of them on account of related terminal income. Each shareholder treated, on its timely filed 1960 income tax return, \$1,000 of its liabilities, which were so reduced and were attributable to income from the United States in payment for facilities and services in connection with mail handling, as if it had received \$1,000 from the G Company as a dividend and paid that \$1,000 to the G Company for services. Each shareholder treated the remaining \$7,000 of its liabilities which were so reduced as if the liabilities which were reduced had never been incurred. Assuming that the provisions of § 1.281-2 otherwise apply, each shareholder shall not be considered to have received or accrued as a dividend, nor to have paid or incurred as an expense \$7,000 (instead of \$8,000).

(2) For any taxable year of a terminal railroad corporation ending before October 23, 1962, a claim for refund or credit of overpayment of income tax based upon section 281 may be filed, even though such refund or credit of overpayment was otherwise barred by operation of any law or rule of law on October 23, 1962, subject to the conditions set forth in paragraph (b)(2)(i) through (v) of this section.

(i) The claim for refund or credit of overpayment must not have been barred by a closing agreement (under either section 3760 of the Internal Revenue Code of 1939 or section 7121 of the Internal Revenue Code of 1954), or by a compromise (under section 3761 of the Internal Revenue Code of 1939 or section 7122 of the Internal Revenue Code of 1954);

(ii) The claim for refund or credit of overpayment shall be allowed only to the extent that the overpayment of income tax results from the recomputation of the terminal railroad corporation's taxable income in the manner described in paragraph (a) of § 1.281-2;

(iii) The claim for refund or credit of the overpayment must have been filed prior to October 23, 1963;

(iv) The claim for refund or credit of overpayment shall be allowed only to the extent that the manner in which the terminal railroad corporation's taxable income is recomputed is the manner in which the terminal railroad corporation's taxable income was computed on its timely filed income tax return for such taxable year; and

(v) Each railroad corporation which was a shareholder of the terminal railroad corporation during such taxable year must consent in writing to the assessment, within such period as may be agreed upon with the district director, of any deficiency for any year (even though assessment of the deficiency would otherwise be prevented by the operation of any law or rule of law at the time of filing the consent) to the extent that:

(A) The deficiency is attributable to the recomputation of the shareholder's taxable income in the manner described in paragraph (b) of § 1.281-2, and

(B) The deficiency results from the shareholder's allocable portion of the "reduced amount" (described in paragraph (c) of § 1.281-2) which gives rise to the refund or credit granted to the terminal railroad corporation under this subparagraph.

[T.D. 7356, 40 FR 23737, June 2, 1975]

§§ 1.282-1.300 [Reserved]