

## § 1.7519-1T

## 26 CFR Ch. I (4-1-10 Edition)

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### § 1.7519-1T Required payments for entities electing not to have required year (temporary).

- (a) *In general*—(1) *Applicability*. This section applies to any taxable year that a partnership or S corporation has an election under section 444 in effect (an “applicable election year”).

(2) *Returns and required payments*. For each applicable election year, a partnership or S corporation must—

- (i) File a return as provided in § 1.7519-2T(a)(2), and
- (ii) Make a required payment (as defined in paragraph (a)(3) of this section) as provided in § 1.7519-2T.

However, if the required payment for an applicable election year is not more than \$500 and the partnership or S corporation has not been required to make a required payment for a prior year, the partnership or S corporation should not make a required payment for such applicable election year.

(3) *Required payment*. The term “required payment” means, with respect to any applicable election year, an amount equal to the excess of—

- (i) The product of the applicable percentage of the adjusted highest section 1 rate, multiplied by the net base year income (as defined in paragraph (b)(5) of this section) of the entity over
- (ii) The cumulative amount of required payments actually made for all preceding applicable election years (reduced by the cumulative amount of such payments refundable under section 7519(c) for all such preceding years).

Furthermore, the amount of the required payment is determined without regard to the required payment of any other partnership or S corporation. See example (3) in paragraph (d) of this section.

(4) *Examples*. The provisions of paragraph (a) of this section may be illustrated by the following examples.

*Example 1.* A, a partnership, makes a section 444 election to retain its taxable year ending September 30. For A’s first applicable election year, A’s required payment, as defined in paragraph (a)(3) of this section, is \$400. Thus, A does not have to make a required payment for that year. However, A is required to file the return prescribed by § 1.7519-2T(a)(2).

*Example 2.* The facts are the same as in example (1), and, in addition to those facts, for A’s second applicable election year, the amount determined under paragraph (a)(3)(i) of this section is \$800. Because A did not actually make a required payment for A’s first applicable election year, A’s required payment is \$800 for its second applicable election year. Since the required payment is greater than \$500, A must make a required

payment for its second applicable election year. Furthermore, A must file the return prescribed by § 1.7519-2T(a)(2).

*Example 3.* The facts are the same as in example (2), and, in addition to those facts, for A's third applicable election year, the amount determined under paragraph (a)(3)(i) of this section is \$1,200. Thus, A's required payment is \$400 (\$1,200 determined under paragraph (a)(3)(i) of this section less \$800 determined under paragraph (a)(3)(ii) of this section). Although A's required payment for its third applicable election year is not more than \$500, A must make its required payment for such year because the required payment for a preceding applicable election year exceeded \$500. A must also file the return prescribed by § 1.7519-2T(a)(2) for its third applicable election year.

(b) *Definitions and special rules—(1) Applicable percentage—(i) In general.* Except as provided in paragraph (b)(1)(ii) of this section, the term “applicable percentage” means the percentage determined in accordance with the following table:

If the applicable election year of the partnership or S corporation begins during—	The applicable percentage is—
1987 .....	.25
1988 .....	.50
1989 .....	.75
1990 or thereafter .....	100

(ii) *Exception for certain applicable election years beginning after 1987.* [Reserved]

(iii) *Example.* The provisions of paragraph (b)(1) of this section may be illustrated by the following example.

*Example.* B is a corporation that has historically used a June 30 taxable year. For its taxable year beginning July 1, 1987, B elects to be an S corporation and elects under § 1.444-1T(b)(3) to retain its June 30 taxable year. Had B changed to a calendar year, its required year under section 1378, B's shareholders would not have been entitled to the 4-year spread under section 806(e)(2)(C) of the Tax Reform Act of 1986 because B was not an S corporation for its taxable year beginning in 1986. Nevertheless, for purposes of determining the required payment for B's applicable election year beginning July 1, 1987, the applicable percentage is 25 percent.

(2) *Adjusted highest section 1 rate—(i) General rule.* For any applicable election year, the term “adjusted highest section 1 rate” means the highest rate of tax under section 1 applicable to the period defined in paragraph (b)(2)(ii) of this section, plus 1 percentage point. Notwithstanding the preceding sen-

tence, the adjusted highest section 1 rate is 36 percent for applicable election years beginning in 1987. For purposes of this section, the highest rate of tax is determined without regard to the effect of section 1(g), relating to the phaseout of the 15-percent rate and personal exemptions.

(ii) *Period for determining highest section 1 rate.* For purposes of paragraph (b)(2)(i) of this section, the period for determining the highest rate of tax under section 1 is the 12 month period that—

- (A) Ends with the required taxable year for the applicable election year, and
- (B) Includes the end of the base year.

For example, assume that a partnership's applicable election year begins on October 1, 1988 and that the required taxable year for such applicable election year is December 31. Based upon these facts, the period for determining the highest section 1 rate is the 12-month period ending December 31, 1988.

(3) *Base year.* The term “base year” means, with respect to any applicable election year, the taxable year of the partnership or S corporation preceding such applicable election year.

(4) *Special rules for certain applicable election years—(i) First applicable election year of new entities.* If an applicable election year is a partnership's or S corporation's first year in existence (*i.e.*, the partnership or S corporation is newly formed and therefore does not have a base year), the required payment for such applicable election year is zero.

(ii) *Applicable election years ending prior to the required taxable year.* If a partnership or S corporation makes a section 444 election and the resulting applicable election year (the “first applicable election year”) of the partnership or S corporation ends prior to the last day of the required year, the required payment for the first applicable election year is zero. See example (5) in paragraph (b)(5)(vi) of this section.

(5) *Net base year income—(i) In general.* Except as provided in paragraph (b)(5)(v) of this section (relating to short base years), the net base year income of a partnership or S corporation is the sum of—

(A) The deferral ratio multiplied by the partnership's or S corporation's net income for the base year, plus

(B) The excess (if any) of—

(1) The deferral ratio multiplied by the aggregate amount of applicable payments made by the partnership or S corporation during the base year, over

(2) The aggregate amount of such applicable payments made during the deferral period of the base year.

The term “deferral ratio” means the ratio which the number of months in the deferral period (as defined in § 1.444-1T (b)(4)) of the applicable election year bears to 12 months.

(ii) *Partnership net income.* For purposes of paragraph (b)(5)(i) of this section—

(A) *In general.* The net income of the partnership is the amount (not below zero) determined by taking into account the aggregate amount of the partnership's items described in section 702(a), except for—

(1) Credits,

(2) Tax-exempt income, and

(3) Guaranteed payments under section 707(c).

(B) *Treatment of deductions and losses.* For purposes of determining the aggregate amount of partnership items, deductions and losses are treated as negative income. Thus, for example, if under section 702(a) a partnership has \$1,000 of ordinary taxable income, \$500 of specially allocated deductions, and \$300 of capital loss, the net income of the partnership is \$200 (\$1,000-\$500-\$300).

(C) *Partner limitations disregarded.* Any limitation on the amount of a partnership item described in section 702(a) which may be taken into account for purposes of computing the taxable income of a partner shall be disregarded in computing the net income of the partnership.

(iii) *S corporation net income.* For purposes of paragraph (b)(5)(i) of this section—

(A) *In general.* The net income of an S corporation is the amount (not below zero) determined by taking into account the aggregate amount of the S corporation's items described in section 1366(a) (other than credits and tax-exempt income). If the S corporation was a C corporation for the base year,

the taxable income of the C corporation shall be treated as the net income of the S corporation for such year.

(B) *Treatment of deductions and losses.*

For purposes of determining the aggregate amount of S corporation items, deductions and losses are treated as negative income. Thus, for example, if under section 1366(a) an S corporation has \$2,000 of ordinary taxable income, \$1,000 of deductions described in section 1366(a)(1)(A) of the Code, and \$500 of capital loss, the net income of the S corporation is \$500 (\$2,000-\$1,000-\$500).

(C) *Shareholder limitations disregarded.* Any limitation on any amount described in section 1366(a) which may be taken into account for purposes of computing the taxable income of a shareholder shall be disregarded in computing the net income of the S corporation.

(iv) *Applicable payments—(A) In general.* The term *applicable payment* means any amount deductible in the base year that is includable at any time, directly or indirectly, in the gross income of a taxpayer that during the base year is a partner or shareholder.

(B) *Exceptions.* The term *applicable payment* does not include any guaranteed payments under section 707(c).

(C) *Special rule for corporation electing S status.* If an S corporation was a C corporation for the base year, the corporation shall be treated as if it were an S corporation for the base year for purposes of determining the amount of applicable payments under this section. Thus, amounts deductible by the C corporation in the base year that are includable at any time in the gross income of a taxpayer that is a shareholder during the base year are treated as if from an S corporation, and therefore within the meaning of the term “applicable payments.”

(D) *Special rules for certain payments—*

(1) *Certain indirect payments.* For purposes of paragraph (b)(5)(iv)(A) of this section, an amount is indirectly includable in the gross income of a partner or shareholder of a partnership or S corporation that has a section 444 election in effect (an electing partnership or S corporation) if the amount is includable in the gross income of—

(i) The spouse (other than a spouse who is legally separated from the partner or shareholder under a decree of divorce or separate maintenance) or child (under age 14) of such partner or shareholder, or

(ii) A corporation more than 50 percent (measured by fair market value) of which is owned in the aggregate by partners or shareholders (and individuals related under paragraph (b)(5)(iv)(D)(I)(i) of this section to any such partners or shareholders), of the electing partnership or S corporation, or

(iii) A partnership more than 50 percent of the profits and capital of which is owned in the aggregate by partners or shareholders (and individuals related under paragraph (b)(5)(iv)(D)(I)(i) of this section to any such partners or shareholders) of the electing partnership or S corporation, or

(iv) A trust more than 50 percent of the beneficial ownership of which is owned in the aggregate by partners or shareholders (and individuals related under paragraph (b)(5)(iv)(D)(I)(i) of this section to any such partners or shareholders), of the electing partnership or S corporation.

For purposes of this paragraph (b)(5)(iv)(D)(I), ownership by any person described in this paragraph (b)(5)(iv)(D)(I) shall be treated as ownership by the partners or shareholders of the electing partnership or S corporation. This paragraph (b)(5)(iv)(D)(I) does not apply to amounts deductible by a partnership or S corporation that has made a section 444 election (the "deducting partnership") and included in the gross income of a partnership or S corporation defined in paragraphs (b)(5)(iv)(D)(I)(ii) or (iii) of this section (the "including partnership"), if the including partnership has the same taxable year as the deducting partnership and the including partnership has a section 444 election in effect. Furthermore, notwithstanding the general effective date provided in § 1.7519-3T, this paragraph (b)(5)(iv)(D)(I) is effective for amounts deductible on or after June 1, 1988.

(2) *Payments by a downstream controlled partnership*—(i) *In general.* If a partnership or S corporation has made a section 444 election, any amounts de-

ducted by a downstream controlled partnership will be considered deducted by the partnership or S corporation that has made the section 444 election for purposes of determining the applicable payments of the partnership or S corporation that has made the section 444 election.

(ii) *Definition of a downstream controlled partnership.* If a partnership or S corporation that has made a section 444 election owns more than 50 percent of a partnership's profits and capital, such owned partnership is considered a downstream controlled partnership for purposes of paragraph (b)(5)(iv)(D)(2)(i) of this section. Furthermore, if more than 50 percent of a partnership's profits and capital are owned by a downstream controlled partnership, such owned partnership is considered a downstream controlled partnership for purposes of paragraph (b)(5)(iv)(D)(2)(i) of this section.

(3) *Examples.* The provisions of this paragraph (b)(5)(iv)(D) may be illustrated by the following examples.

*Example 1.* I1 and I2, calendar year individuals, own 100 percent of the profits and capital of C1, a partnership. In addition to owning C1, I1 and I2 also own 100 percent of the profits and capital of C2, a calendar year partnership. For its taxable years beginning February 1, 1987, 1988, and 1989, C1 has a section 444 election in effect to use a January 31 taxable year. During its base years beginning February 1, 1986, 1987, and 1988, C1 deducted \$10,000, \$11,000, and \$12,000, respectively that was included in C2's gross income. Furthermore, of the \$12,000 deducted by C1 for its taxable year beginning February 1, 1988, \$7,000 was deducted during the period June 1, 1988 to January 31, 1989. Pursuant to paragraph (b)(5)(iv)(D)(I) of this section, the \$7,000 deducted by C1 on or after June 1, 1988, and included in C2's gross income is considered an applicable payment for C1's base year beginning February 1, 1988. Amounts deducted by C1 prior to June 1, 1988, are not subject to paragraph (b)(5)(iv)(D)(I) of this section.

*Example 2.* The facts are the same as in example (1), except that I1 and I2 own only 51 percent of C2's profits and capital. Since the two partners in C1 (*i.e.*, I1 and I2) own more than 50 percent of C2's profits and capital, C2 is considered controlled by the partners of C1 pursuant to paragraph (b)(5)(iv)(D)(I)(iii) of this section. Thus, the conclusions in example (1) are unchanged. Furthermore, if the \$7,000 deducted by C1 was included in the income of a partnership more than 50 percent of the profits and capital of which is owned

by C2, such \$7,000 would be considered an applicable payment for its base year beginning February 1, 1988.

*Example 3.* The facts are the same as in example (1), except that for its taxable years beginning February 1, 1987, 1988, and 1989, C2 has a section 444 election in effect to use a January 31 taxable year. Since both C1 and C2 have the same taxable year and both have section 444 elections in effect, paragraph (b)(5)(iv)(D)(1) of this section does not apply to the \$7,000 deducted by C1 for its base year beginning February 1, 1988.

*Example 4.* I3 and I4, calendar year individuals, own 100 percent of the profits and capital of C3, a partnership. C3 has made a section 444 election to retain a year ending June 30 for its taxable year beginning July 1, 1987. Furthermore, C3 owns more than 50 percent of the profits and capital of C4, a partnership that historically used a June 30 taxable year. Pursuant to § 1.706-3T(b), C4 retains its year ending June 30 for its taxable year beginning July 1, 1987. For its taxable year beginning July 1, 1986, C4 deducted \$20,000 that was included in I3's gross income. Pursuant to paragraph (b)(5)(iv)(D)(2) of this section, the \$20,000 deducted by C4 is considered an applicable payment by C3 for its base year beginning July 1, 1986.

*Example 5.* The facts are the same as in example (4), except that the \$20,000 deducted by C4 is included in the gross income of a calendar year partnership 100 percent owned by I3 and I4. Pursuant to paragraphs (b)(5)(v)(D)(1) and (2) of this section, the \$20,000 deducted by C4 is considered an applicable payment by C3 for its base year beginning July 1, 1986.

*Example 6.* The facts are the same as in example (4), except that instead of directly owning a portion of C4, C3 owns more than 50 percent of the profits and capital of C5. Furthermore, C5 owns more than 50 percent of the profits and capital of C4. Pursuant to paragraph (b)(5)(iv)(D)(2)(ii) of this section, both C5 and C4 are considered downstream controlled partnerships of C3. Thus, pursuant to paragraph (b)(5)(iv)(D)(2)(i) of this section, the \$20,000 deducted by C4 is considered an applicable payment by C3 for its base year beginning July 1, 1986.

(v) *Special rule for base year of less than twelve months—(A) In general.* If a base year is a taxable year of less than twelve months (a "short base year"), net base year income for such year is an amount equal to the excess, if any, of—

(1) The deferral ratio multiplied by the annualized short base year income, over

(2) Applicable payments made during the deferral period of the applicable election year following the base year.

(B) *Annualized short base year income.* The annualized short base year income is determined by—

(1) Increasing the net income for the short base year by applicable payments deductible in the short base year, and

(2) Multiplying the short base year income as increased in paragraph (b)(5)(v)(B)(1) of this section by twelve, and dividing the result by the number of months in the short base year.

(vi) *Examples.* The provisions of paragraph (b)(5) of this section may be illustrated by the following examples.

*Example 1.* D, a partnership, is owned 10 percent by a C corporation with a September 30 taxable year and 90 percent by calendar year individuals. D has historically used a September 30 taxable year. For its taxable year beginning October 1, 1987, D makes a section 444 election to retain its September 30 taxable year. For the base year from October 1, 1986 to September 30, 1987, D has net income of \$200,000 and no applicable payments. D's deferral ratio is  $\frac{3}{12}$  (the ratio of the number of months in the deferral period to 12 months). Based upon these facts, D has net base year income of \$50,000 ( $\$200,000 \times \frac{3}{12}$ ).

*Example 2.* The facts are the same as in example (1) except that D's net income for the base year is \$140,000, after applicable payments of \$60,000. Of the applicable payments \$15,000 were deductible during the deferral period of the base year. Based upon these facts, D has net base year income of \$35,000, determined as follows:

Net income multiplied by deferral ratio .....	\$140,000 $\times \frac{3}{12}$		
Plus the excess, if any, of applicable payments multiplied by deferral ratio .....	\$60,000 $\times \frac{3}{12}$	\$15,000	\$35,000
Over aggregate amount of applicable payments deductible during deferral period of base year .....		\$15,000	0
Net base year income			\$35,000

*Example 3.* The facts are the same as in example (2) except that of the \$60,000 applicable payments only \$10,000 are deductible during the deferral period of the base year. Based on these facts, D has net base year income of \$40,000, determined as follows:

Net income multiplied by deferral ratio .....	\$140,000		
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	x 3/12		
Plus the excess, if any, of applicable payments multiplied by deferral ratio .....	\$60,000 x 3/12	\$35,000	
Over aggregate amount of applicable payments deductible during deferral period of base year .....		\$15,000	
		\$10,000	\$5,000
Net base year income			\$40,000

Net base year income .....	\$137,500
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*Example 4.* E is a C corporation that has historically used a January 31 taxable year. For its taxable year beginning February 1, 1987, E makes an election to be an S corporation and also makes a section 444 election to retain its January 31 taxable year. E's taxable income for the taxable year beginning February 1, 1986 to January 31, 1987 is \$120,000. Pursuant to paragraph (b)(5)(iii)(A) of this section, the base year for X's first applicable election year is the taxable year beginning February 1, 1986 and ending January 31, 1987. Thus, E's net income for the base year is \$120,000. During the base year, E pays its sole shareholder, A, a salary of \$5,000 a month plus a \$30,000 bonus on January 15, 1987. Thus, under paragraph (b)(5)(iv)(C) of this section, E's applicable payments for the base year are \$90,000, of which \$55,000 are applicable payments deductible during the deferral period of the base year (February 1 to December 31, 1986). Based upon these facts, E's net base year income is \$137,500, determined as follows:

Net income multiplied by deferral ratio	\$120,000 x 11/12		
Plus the excess, if any, of applicable payments multiplied by the deferral ratio .....	\$90,000 x 11/12	\$110,000	
Over aggregate amount of applicable payments deductible during deferral period of base year ...		\$82,500	
		\$55,000	\$27,500

*Example 5.* E, a corporation that has historically used a taxable year ending July 31, makes an election to be an S corporation for its taxable year beginning August 1, 1987. For that year, E also makes a section 444 election to use a taxable year ending September 30. Thus, E has two applicable election years beginning in 1987, the first beginning August 1, 1987 and ending September 30, 1987, and the second beginning October 1, 1987 and ending September 30, 1988. E's required year under section 1378 is the calendar year. Because E's first applicable election year ends prior to the last day of E's required year (i.e., December 31, 1987), the required payment for E's first applicable election year is zero. However, E is required to file a return for such year as provided in § 1.7519-2T.

*Example 6.* The facts are the same as in example (5). E's second applicable election year is the year from October 1, 1987 to September 30, 1988, and the base year for the second applicable election year is a period of less than 12 months (i.e., August 1, 1987 to September 30, 1987). Thus, E must compute its net base year income using the special rule for short base years provided in paragraph (b)(5)(v) of this section. Assume E's net income for the short base year is \$50,000, and E's applicable payments for the short base year are \$15,000. Pursuant to paragraph (b)(5)(v)(B) of this section, E's annualized short base year net income is \$390,000 ( $\$65,000 \times 12/2$ ). Furthermore, assume E's applicable payments for the deferral period of its second applicable election year are \$20,000. Based on these facts, the net base year income for the applicable election year beginning October 1, 1987 is \$77,500, computed as follows:

Annualized short base year income multiplied by deferral ratio .....	\$390,000 x 3/12		
Less:			
Applicable payments for deferral period .....		\$97,500	
Net base year income			\$20,000
			\$77,500

(c) *Refunds of required payments.* A partnership of S corporation is entitled to make a claim for refund, in accordance with the procedures provided in § 1.7519-2T(a)(6), if—

- (1) The amount specified in paragraph (a)(3)(i) of this section is less than the amount specified in paragraph (a)(3)(ii) of this section; or

(2) The partnership or S corporation terminates its section 444 election, within the meaning of § 1.444-1T(a)(5).

(d) *Example.* The provisions of this section may be illustrated by the following examples.

*Example 1.* G, a partnership, is owned 10 percent by a C corporation with a June 30 taxable year, and 90 percent by calendar year individuals. G has historically used a June 30 taxable year. For its taxable year beginning July 1, 1987, G makes a section 444 election to retain its June 30 taxable year. For the base year from July 1, 1986 to June 30, 1987, G has net income of \$300,000 and no applicable payments. G's deferral ratio is 6/12 (the ratio of the number of months in the deferral period to 12 months). Based on these facts, G's net base year income is \$150,000 ( $\$300,000 \times 6/12$ ). Thus, G's required payment for its first applicable election year is \$13,500 ( $\$150,000$  of net base year income multiplied by 9 percent (the product of the applicable percentage for 1987, 25 percent, and the highest section 1 rate for 1987, 36 percent)).

*Example 2.* The facts are the same as in example (1). In addition, G continues its section 444 election for the taxable year beginning July 1, 1988, and G's net base year income for the year beginning July 1, 1987 is \$150,000. The required payment for G's second applicable election year is \$8,250 ( $\$150,000$  of net base year income multiplied by 14.5 percent (the product of the applicable percentage for 1988 applicable election years, 50 percent, and the adjusted highest section 1 rate for 1988, 29 percent) less G's \$13,500 required payment for the first applicable election year).

*Example 3.* H, a partnership with a taxable year ending September 30, desires to make a section 444 election for its taxable year beginning October 1, 1987. H is 15 percent owned by I, a partnership with a taxable year ending September 30, and 85 percent owned by calendar year individuals. Assume H and I are qualified to make section 444 elections as a result of the "same taxable year exception" provided in § 1.444-2T(e). If H and I make section 444 elections, they must each make a required payment (assuming the amount computed under paragraph (a)(3) of this section is greater than \$500). Pursuant to paragraph (a)(3) of this section, the required payments of H and I are calculated independent of each other. Thus, in determining the amount of its required payment, I may not exclude its income attributable to H, even though H must also make a required payment on the same income.

*Example 4.* The facts are the same as in example (1) except that H is 90 percent owned by I and 10 percent owned by calendar year individuals. Pursuant to § 1.706-3T, if I makes a section 444 election to retain its taxable

year ending September 30, H's required year will be September 30, because H's majority interest partner will have a September 30 taxable year. Thus, H is not required to make a section 444 election and a required payment in order to use a September 30 taxable year. I, however, must make a required payment.

[T.D. 8205, 53 FR 19706, May 27, 1988]

**§ 1.7519-2T Required payments—procedures and administration (temporary).**

(a) *Payment and return required—(1) In general.* With respect to any taxable year for which a partnership or S corporation has a section 444 election in effect (an "applicable election year"), the partnership or S corporation shall file a return as provided in paragraphs (a) (2) and (3) of this section and make a payment, if required, as provided in paragraph (a)(4) of this section.

(2) *Return required—(i) In general.* A return showing the required payment shall be made, even if the required payment for the applicable election year is zero. For an applicable election year beginning in 1987, the return shall be made on Form 720, "Quarterly Federal Excise Tax Return." For an applicable election year beginning after 1987, the return shall also be made on Form 720 unless another form is prescribed by the Commissioner.

(ii) *Procedure if amount for applicable election year (and all preceding years) is not greater than \$500.* If a partnership or S corporation is not required to make a payment under section 7519 for an applicable election year, the partnership or S corporation should type or legibly print "zero" on the appropriate line of the prescribed form.

(3) *Time and place for filing return—(i) Applicable election years beginning in 1987.* For an applicable election year beginning in 1987, the Form 720 must be filed with the Service Center indicated by the instructions for the Form 720. The date for filing such form is as follows—

(A) *Taxpayers that would otherwise file Form 720 for the second quarter of 1988.* Taxpayers that are required, without regard to this section, to file Form 720 for the second quarter of 1988 (e.g., taxpayers reporting liability for manufacturers excise tax) must file Form 720 by the normal due date of such form for