

	Penalty for 1982 failure	Penalty for 1983 failure	Total penalty for given year
For failure to file 1983 return (\$25 per day×230 days)		\$5,750	
Total			\$14,900
Penalty incurred in 1985:			
For failure to file 1982 return (\$25 per day×365 days)	9,125		
For failure to file 1983 return (\$25 per day×365 days)		9,125	
Total			18,250
Penalty incurred in 1986:			
For failure to file 1982 return (lesser of \$25 per day×365 days or \$975 (remaining penalty which may be imposed))	975		
For failure to file 1983 return (\$25 per day×365 days)		9,125	
Total			10,100
Penalty incurred in 1987:			
For failure to file 1983 return (lesser of \$25 per day×365 days or \$1,000 (remaining penalty which may be imposed))		1,000	
Total			1,000

Example (3). Foreign corporation Y is required under section 6039C(b)(1) to make a return for calendar year 1982. In addition, Y is required under section 6039C(b)(3) to furnish statements to each substantial investor in U.S. real property interests. Y has 10 such substantial investors. Y does not file such return on or before May 15, 1983 as required under §6a.6039C-1(c), nor does it furnish the required statements on or before January 31, 1983 as required under §6a.6039C-3(h). The failure to file the return for calendar year 1982 and to furnish the required statements for 1982 continues throughout calendar years 1984 and 1985. The failure to meet the requirements of section 6039C(b) are not due to reasonable cause and no security has been furnished in lieu of filing. The total penalty which can be imposed on Y for failure to file the return and statements required under section 6039C(b) for calendar year 1982 is \$25,000. The amount of penalty incurred by Y in calendar year 1983 for failure to file the return and statements for calendar year 1982 is \$25,000, determined as follows:

Penalty incurred in 1982:		
For failure to file return (\$25 per day×230 days)		\$5,750

For each failure to furnish a statement required by section 6039C(b)(3) (\$25 per day×10 statements×the 334 days from February 1, 1983 to December 31, 1983 (\$83,500) but not more than \$19,250 (which when added to \$5,750 would total \$25,000))

19,250
Total
25,000

Since Y has incurred the maximum penalty for failure to file its return and statements required for 1982 by the end of calendar year 1983, no further penalty for these failures is imposed.

Example (4). Under section 6039C(c) foreign person Y is required to make a return for calendar year 1982. Y does not file such return on May 15, 1983 and the failure is not due to reasonable cause. No security has been furnished in lieu of filing. All properties owned by Y in 1982 are U.S. real property interests. Y purchased property M in January 1982 when its fair market value was \$10,000. In March, Y purchased property N when its fair market value was \$15,000. In November, Y sold property M for \$20,000. The fair market value of property N on December 31, 1982, was \$20,000. The total of the fair market values of M and N (M as of the date of its sale and N as of December 31, 1982) is \$40,000. The maximum penalty which may be imposed on Y for failure to meet the requirements of section 6039C(c) for any calendar year is the lesser of \$25,000 or 5 percent of the aggregate of the fair market values of the U.S. real property interests owned by Y at any time during such calendar year. Since \$2,000 (5 percent of \$40,000) is less than \$5,750 (\$25 times 230 days, the number of days in calendar year 1983 for which the failure continues), the maximum penalty which may be imposed on Y in 1983 is \$2,000. Since the maximum penalty for the failure to file the 1982 return is incurred in 1983, no amount may be imposed for Y's continuing failure to file the return for calendar year 1982 during calendar years after 1983.

(h) *Effective date.* This section shall apply to 1980 and subsequent calendar years. The calendar year 1980 shall be treated as beginning on June 19, 1980 and ending on December 31, 1980.

[T.D. 7866, 48 FR 648, Jan. 6, 1983]

PART 7—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

Sec.

7.48-1 Election to have investment credit for movie and television films determined in accordance with previous litigation.

7.48-2 Election of forty-percent method of determining investment credit for movie

Internal Revenue Service, Treasury

§ 7.48-2

- and television films placed in service in a taxable year beginning before January 1, 1975.
- 7.48-3 Election to apply the amendments made by sections 804 (a) and (b) of the Tax Reform Act of 1976 to property described in section 50(a) of the Code.
- 7.57(d)-1 Election with respect to straight line recovery of intangibles.
- 7.105-1 Questions and answers relating to exclusions of certain disability income payments.
- 7.105-2 Substantial gainful activity.
- 7.465-1 Amounts at risk with respect to activities begun prior to effective date; in general.
- 7.465-2 Determination of amount at risk.
- 7.465-3 Allocation of loss for different taxable years.
- 7.465-4 Insufficient records.
- 7.465-5 Examples.
- 7.704-1 Partner's distributive share.
- 7.936-1 Qualified possession source investment income.
- 7.999-1 Computation of the international boycott factor.
- 7.6039A-1 Information regarding carryover basis property acquired from a decedent.
- 7.6041-1 Return of information as to payments of winnings from bingo, keno, and slot machines.

AUTHORITY: 26 U.S.C. 7805, unless otherwise stated.

§ 7.48-1 Election to have investment credit for movie and television films determined in accordance with previous litigation.

(a) *Generally.* Under section 804(c)(3) of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1595), any taxpayer who filed an action in any court of competent jurisdiction before January 1, 1976, for a determination of such taxpayer's rights to investment credit under section 38 of the Internal Revenue Code of 1954 with respect to any film placed in service in any taxable year beginning before January 1, 1975, may elect to have investment credit on all films placed in service in taxable years beginning before January 1, 1975, (except those subject to an election under section 804(e)(2) of the Act), determined as though section 804 of the Act (except section 804(c)(3) of the Act) had not been enacted.

(b) *Manner of making the election.* The election allowed by section 804(c)(3) of the Act may be made by a notification in the form of a letter signed by the taxpayer or an authorized representative of the taxpayer stating:

(1) The taxpayer's name, address, and identification number;

(2) The taxable years in which the films were placed in service with respect to which the election shall apply; and

(3) The court in which the litigation was commenced and information adequate to identify the particular litigation, for example, the names of the litigants, the date the suit was commenced, and the court case or docket number of the litigation.

The letter should be sent to the Deputy Commissioner of Internal Revenue, Attention: CC:RL:Br2, Room 4617, 1111 Constitution Avenue, N.W., Washington, DC 20224.

(c) *Time for making the election.* The election under section 804(c)(3) of the Act must be made not later than January 3, 1977. If mailed, the cover containing the notification of such election must be postmarked not later than January 3, 1977.

(d) *Revocation of election.* An election under section 804(c)(3) of the Act, once made, shall be irrevocable.

[T.D. 7449, 41 FR 56629, Dec. 29, 1976]

§ 7.48-2 Election of forty-percent method of determining investment credit for movie and television films placed in service in a taxable year beginning before January 1, 1975.

(a) *General rule.* Under section 804(c)(2) of the Tax Reform Act of 1976 (90 Stat. 1595), taxpayers who placed movie or television films (hereinafter referred to as films and tapes) in service during taxable years beginning before January 1, 1975, may elect to have their investment credit on all such films and tapes determined under section 46(c) of the Code using an amount equal to 40 percent of aggregate production costs in lieu of the basis of such property. If the election is made, 100 percent is the applicable percentage used in determining qualified investment under section 46(c) of the Code regardless of actual useful life. The election can be made only with respect to qualified films and tapes that are new section 38 property and the investment credit is allowed only to the extent that a taxpayer has an ownership interest in the film or tape. No investment credit is allowed under section 804(c)(2)

of the Act on any film or tape that is not section 38 property or that was produced and shown exclusively outside of the United States. Thus, no election may be made under this section with respect to a film or tape which is suspension period property to which section 48(h) applies or to a film or tape which is termination period property to which section 49(a) applies. Any investment credit taken on any film or tape subject to the election is not subject to recapture because of an early disposition or because a film or tape otherwise ceases to be section 38 property under section 47(a) of the Code. Thus, there will be no recapture because a film or tape is used outside the United States under section 48(a)(2) of the Code or section 804(c)(1)(C) of the Act, or because of any disposition under section 47(a)(7)(B) of the Code.

(b) *Time and manner of making an election*—(1) *Time for making the election.* The election under section 804(c)(2) of the Act must be made not later than April 25, 1977.

(2) *Manner of making the election.* An election under this section must be made by filing amended income tax returns for each taxable year beginning before January 1, 1975, in which films and tapes subject to the election were placed in service, together with a statement signed by the taxpayer containing the information described below. The amended returns and the statement must be filed with the district director having audit jurisdiction over the last return filed to which the election relates. Each amended return shall contain a schedule listing by name all films and tapes placed in service during the year to which the amended return relates and setting forth all computations necessary to determine the aggregate production costs of each such film or tape listed and the ownership interest of the taxpayer in each film or tape listed. In the case of a taxpayer which is a partner, shareholder of an electing small business corporation, or beneficiary of a trust or estate, such computations must be adequate to determine the ownership interest of the partnership, electing small business corporation, or trust or estate in each such film or tape, (a taxpayer which is a partner, shareholder,

or beneficiary may satisfy the requirements of the preceding sentence by attaching to his amended return a copy of an amended return, if one is filed, of the partnership, electing small business corporation, or trust or estate which sets forth computations necessary to determine the ownership interest of the entity in each such film or tape.) No amended return need be filed for a taxable year if application of the election to films and tapes placed in service during that year would not affect tax liability for any taxable year.

The statement shall contain the following information:

(i) The taxpayer's name and taxpayer identification number (under section 6109 of the Code).

(ii) A statement that the taxpayer is making the election under section 804(c)(2) of the Act.

(iii) A statement that the taxpayer agrees that the period for assessment and collection under section 6501 of the Code will remain open until December 31, 1978, solely with respect to adjustments of tax liability attributable to investment credit allowed on films and tapes placed in service in each year covered by the election. Unless the district director notifies the taxpayer within 7 days of receipt of the statement that such extension is denied, it will be presumed that the district director consents to such extension. Of course, the period covered by this statement may be extended beyond December 31, 1978 by mutual agreement. This statement does not shorten the regular statutory period for any year or take precedence over a previous or subsequent agreement with the Internal Revenue Service extending the statutory period for any year.

(iv) A list of the addresses used by the taxpayer on each return filed during each taxable year subject to the election.

(v) A statement that the taxpayer consents to join in judicial proceedings to determine the investment credit allowable and entitlement to investment credit on any film or tape subject to the election, which meets all of the requirements set forth in paragraph (b)(3) of this section.

(vi) A statement as to whether an election has been made by the taxpayer

under section 804(e)(2) of the Act for films and tapes which are property described in section 50(a) of the Code which were placed in service in taxable years beginning before January 1, 1975.

(vii) A list by name of all films or tapes placed in service during the years to which the election relates.

(viii) With respect to each film or tape listed in paragraph (b)(2)(vii) of this section, a list of all producers, distributors, and persons with a participation interest (with addresses where available).

(ix) In the case of an election made by a partner, shareholder of an electing small business corporation (as defined in section 1371(b) of the Code), or beneficiary, a statement indicating the name, taxpayer identification number, and address for tax return purposes of the respective partnership, electing small business corporation, or trust or estate.

(3) *Consent to join in judicial proceedings.* No election may be made by any taxpayer unless the statement made under paragraph (b)(2)(v) of this section provides that the taxpayer shall:

(i) Treat the determination of the investment credit allowable on each film or tape subject to an election as a separate cause of action;

(ii) Make all reasonable efforts necessary to join in or intervene in any judicial proceeding in any court for determining the person entitled to, and the amount of, the investment credit allowable with respect to any film or tape covered by the election after receiving notice from the Commissioner of Internal Revenue or his delegate indicating that a conflicting claim to the investment credit for such film or tape is being asserted in such court by another person; and

(iii) Consent to revocation of the election by the Commissioner of Internal Revenue or his delegate with respect to all films and tapes placed in service in taxable years for which the election applies, if the taxpayer fails to make all reasonable efforts necessary to join in or intervene in any judicial proceeding under paragraph (b)(3)(ii) of this section.

(4) *Who makes the election.* The election must be made separately by each

person who has an ownership interest. However, where a film or tape is owned by a partnership, electing small business corporation (as defined in section 1371(b) of the Code), or trust or estate, the election must be made separately by each partner, shareholder or beneficiary. The election is not to be made by a partnership or electing small business corporation, and is to be made by a trust or estate only if the trust or estate in determining its tax liability would be allowed investment credit on a film or tape subject to the election. The election of any partner, shareholder, beneficiary or trust or estate shall be effective regardless of whether any related partner, shareholder, beneficiary, or trust or estate makes the election.

(5) *Additional time to perfect election.* A taxpayer that by April 25, 1977, files a statement containing the information described in paragraph (b)(2) (i) through (v) of this section shall be deemed to have made a timely election under paragraph (b)(2) of this section if by July 5, 1977, the taxpayer has complied with all of the requirements of paragraph (b)(2) of this section. If a taxpayer demonstrates to the satisfaction of the district director that it is unable to meet the July 5, 1977, date even though it has made a good faith effort to do so, the district director may at his discretion extend that date to no later than October 4, 1977, for that taxpayer. Requests for extensions of the July 5, 1977, date should be addressed to the district director with whom the statement was filed.

(c) *Revocation of election—(1) Revocation by taxpayer.* (i) Except as provided in paragraph (c)(1)(ii) of this section, an election made under section 804(c)(2) of the Act may not be revoked by a taxpayer unless consent to revoke the election is obtained from the Commissioner of Internal Revenue or his delegate. Application for consent to revoke the election will be accepted only if permanent regulations are issued which contain rules which may not reasonably have been anticipated by taxpayers at the time the election was made. Any permanent regulations will provide a reasonable period of time within which taxpayers will be permitted to apply for consent to revoke

the election and will allow revocation (where revocation is not barred by the limitations on credit or refund inspection 6511 of the Code) in the event of a determination by the Commissioner of Internal Revenue or his delegate that such permanent regulations contain provisions that may not reasonably have been anticipated by taxpayers at the time of making such election.

(ii) An election properly made under section 804(e)(2) of the Act, to have sections 48(k) and 47 (a)(7) of the Code apply to films and tapes which are property described in section 50(a) of the Code and which were placed in service in taxable years beginning before January 1, 1975, shall automatically revoke any election under section 804(c)(2) of the Act with respect to such films and tapes. Such revocation does not require the consent of the Commissioner of Internal Revenue or his delegate.

(2) *Revocation by Commissioner.* The Commissioner of Internal Revenue or his delegate shall revoke an election made under section 804(c)(2) of the Act if a taxpayer fails to make all reasonable efforts necessary to join in or intervene, in a judicial proceeding for determination of the person entitled to, and the amount of, the investment credit allowable with respect to any film or tape covered by the election after receiving notice from the Commissioner or his delegate which indicates that a conflicting claim to the investment credit for such film or tape is being asserted in court by another person.

(d) *Furnishing of supplementary information required.* If these regulations are revised to require the furnishing of information in addition to that which was furnished with the amended returns and statement of election filed pursuant to paragraph (b) (2) and (3) of this section, the taxpayer must furnish such additional information in a statement addressed to the district director with whom the amended return and statement of election were filed.

((68A Stat. 917; 26 U.S.C. 7804); sec. 804(c)(2) (C) and (D) of the Tax Reform Act of 1976 (90 Stat. 1595))

[T.D. 7474, 42 FR 17123, Mar. 31, 1977; T.D. 7480, 42 FR 19479, Apr. 14, 1977]

§7.48-3 Election to apply the amendments made by sections 804 (a) and (b) of the Tax Reform Act of 1976 to property described in section 50(a) of the Code.

(a) *General rule.* Under section 804(e)(2) of the Tax Reform Act of 1976 (90 Stat. 1596), taxpayers may elect to apply the amendments made by section 804 (a) and (b) of the Act to movie and television films that are property described in section 50(a) of the Code and that were placed in service in taxable years beginning before January 1, 1975.

(b) *Time for and manner of making election—*(1) *Time for making election.* The election under section 804(e)(2) the Act must be made not later than October 4, 1977.

(2) *Manner of making election.* The election under section 804(e)(2) shall be made by applying the same rules applicable under section 804(c)(2) as described in §7.48-2(b) (2), (3), and (4) except that §7.48-2(b)(2)(ii) shall be read to require a statement that the taxpayer is making an election under section 804(e)(2) of the Act, and §7.48-2(b)(2)(vi) shall not apply. An election properly made under section 804(e)(2) of the Act may not be revoked after October 4, 1977.

(Sec. 804(e)(2), Tax Reform Act of 1976 (90 Stat. 1596))

[T.D. 7509, 42 FR 47828, Sept. 22, 1977]

§7.57(d)-1 Election with respect to straight line recovery of intangibles.

(a) *Purpose.* This section prescribes rules for making the election permitted under section 57(d)(2), as added by the Tax Reform Act of 1976. Under this election taxpayers may use cost depletion to compute straight line recovery of intangibles.

(b) *Election.* The election under section 57(d) is subject to the following rules:

(1) The election is made within the time prescribed by law (including extensions thereof) for filing the return for the taxable year in which the intangible drilling costs are paid or incurred or, if later, by July 25, 1978.

(2) The election is made separately for each well. Thus, a taxpayer may make the election for only some of his or her wells.

(3) The election is made by using, for the well or wells to which the election applies, cost depletion to compute straight line recovery of intangibles for purposes of determining the amount of the preference under section 57(a)(11).

(4) The election may be made whether or not the taxpayer uses cost depletion in computing taxable income.

(5) The election is made by a partnership rather than by each partner.

(c) *Computation of cost depletion.* For purposes of computing straight line recovery of intangibles through cost depletion, both depletable and depreciable intangible drilling and development costs for the taxable year are taken into account. They are treated as if capitalized, added to basis, and recovered under § 1.611-2(a). Costs paid or incurred in other taxable years are not taken into account.

(Secs. 57(d) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1551; 68A Stat. 917; 26 U.S.C. 57(d), 7805))

[T.D. 7541, 43 FR 17816, Apr. 26, 1978; 43 FR 18993, May 3, 1978]

§ 7.105-1 Questions and answers relating to exclusions of certain disability income payments.

The following questions and answers relate to the exclusion of certain disability income payments under section 105(d) of the Internal Revenue Code of 1954, as amended by sections 505 (a) and (c) of the Tax Reform Act of 1976 (90 Stat. 1566):

Q-1: What effect on the sick pay exclusion does the new law have?

A-1: The "sick pay" provisions of prior law (which allowed a limited exclusion from gross income of sick pay received before mandatory retirement age by active employees temporarily absent from work because of sickness or injury, as well as by disability retirees) have been replaced by provisions of the new law (which provide for a limited exclusion of disability payments but restrict its application to individuals retired on disability who meet certain requirements as to permanent and total disability, age, etc.) (Q-4). As a result of the more restrictive provisions of the new law, many taxpayers who qualified for the exclusion in previous taxable years will not be eligible to claim the disability payments exclusion beginning with the effective date of the new law.

Q-2: What is the effective date of the new law relating to disability exclusion?

A-2: The disability income exclusion and related annuity provisions of the Tax Reform Act of 1976 are effective for taxable years beginning on or after January 1, 1977. In addition, the Tax Reduction and Simplification Act of 1977 allows certain taxpayers to begin excluding pension or annuity costs in taxable years beginning in 1976. In the case of a retiree who uses the cash receipts and disbursements method of accounting, the new law applies to payments received on or after the effective date even if the payment is for a period before the effective date. Thus, a payment for December 1976 that is received in January 1977 by a calendar-year, cash-basis taxpayer is controlled by the new law.

Q-3: What are disability payments?

A-3: In general, disability payments are amounts constituting wages or payments in lieu of wages made under provisions of a plan providing for the payment of such amounts to an employee for a period during which the employee is absent from work on account of permanent and total disability. Amounts paid to such an employee after mandatory retirement age is attained are not wages or payments in lieu of wages for purposes of the disability income exclusion.

Q-4: Who is eligible to exclude disability payments?

A-4: A taxpayer who receives disability payments in lieu of wages under a plan providing for the payment of such amounts may qualify for the exclusion provided all of the following requirements are met:

- (1) The taxpayer has not reached age 65 (see Q-9) before the end of the taxable year;
- (2) The taxpayer has not reached mandatory retirement age (see Q-8) before the beginning of the taxable year;
- (3) The taxpayer retired on disability (see Q-10) (or if retired prior to January 1, 1977 and did not retire on disability, would have been eligible to retire on disability at the time of such retirement);
- (4) The taxpayer was permanently and totally disabled (see Q-11) when the taxpayer retired (or if the taxpayer retired before January 1, 1977, was permanently and totally disabled on January 1, 1976, or January 1, 1977); and
- (5) The taxpayer has not made an irrevocable election not to claim the disability income exclusion (see Q-17 through Q-19).

Q-5: What limitations are placed on the amounts excludable?

A-5: The amount of disability income that is excludable:

- (a) Cannot exceed the amount of the disability income payments received for any pay period;
- (b) Cannot exceed a maximum weekly rate of \$100 per taxpayer. Thus, the maximum disability income exclusion allowable on a joint return (see Q-7) in the usual case where one spouse receives disability payments, generally, would be \$5,200, and if both spouses

received disability payments the maximum exclusion, generally, would be \$10,400 (\$5,200 for each spouse);

(c) Cannot exceed, in the case of a disability income payment for a period of less than a week, a prorated portion of the amount otherwise excludable for that week (see Q-6); and

(d) Cannot exceed, for the entire taxable year, the total amount otherwise excludable for such taxable year reduced, dollar for dollar, by the amount by which the taxpayer's adjusted gross income (determined without regard to the disability income exclusion) exceeds \$15,000. Where a disability income exclusion is claimed by either or both spouses on a joint return, the taxpayer's adjusted gross income means the total adjusted gross income of both spouses combined (determined without regard to the disability income exclusion) (see also Q-7).

Q-6: *On what occasion is a taxpayer likely to receive part-week disability payments? How do you prorate such payments?*

A-6: Such part-week payments may be received when one of the following events occurs after the first day of the taxpayer's normal workweek: (a) the disability retirement commences; (b) the taxpayer reaches mandatory retirement age in a taxable year prior to the taxable year in which such taxpayer attains age 65; or (c) the taxpayer dies. To prorate a part-week disability income payment for purposes of the exclusion, the taxpayer must:

(1) Determine the "daily exclusion," which is the lesser of—

(a) The taxpayer's daily rate of disability pay, or

(b) \$100 divided by the number of days in the taxpayer's normal workweek.

(2) Multiply the daily exclusion by the number of days for which the part-week payment was made.

Thus, for a taxpayer whose normal workweek was Monday through Friday and whose retirement on permanent and total disability began on Wednesday, the first disability income payment would include a payment for a part-week consisting of three days. Assuming that the daily exclusion determined in (1), above, is \$20, the taxpayer's exclusion for the first week would be \$60 (\$20×3).

Q-7: *What filing restrictions apply to a married taxpayer who claims a disability income exclusion?*

A-7: A taxpayer married at the close of the taxable year who lived with his or her spouse at any time during such taxable year must file a joint return in order to claim the disability income exclusion. However, a taxpayer married at the close of the taxable year who lived apart from his or her spouse for the entire taxable year may claim the exclusion on either a joint or separate return.

Q-8: *What is "mandatory retirement age"?*

A-8: Generally, mandatory retirement age is the age at which the taxpayer would have been required to retire under the employer's retirement program, had the taxpayer not become disabled.

Q-9: *Does a taxpayer reach age 65 on the day before his or her 65th birthday for purposes of the disability income exclusion, as is the case for purposes of the exemption for age and the credit for the elderly?*

A-9: No. For purposes of the disability income exclusion, a taxpayer reaches age 65 on the day of his or her 65th birthday anniversary. Thus, a taxpayer whose 65th birthday occurs on January 1, 1978, is not considered to reach age 65 during 1977, for purposes of the disability income exclusion.

Q-10: *What does "retired on disability" mean?*

A-10: Generally, it means that an employee has ceased active employment in all respects because of a disability and has retired under a disability provision of a plan for employees. However, an employee who has actually ceased active employment in all respects because of a disability may be treated as "retired on disability" even though the employee has not yet gone through formal "retirement" procedures, as for example, where an employer carries the disabled employee in a non-retired status under the disability provisions of the plan solely for the purpose of continuing such employee's eligibility for certain employer-provided fringe benefits. In addition, such an employee may be treated as "retired on disability" even though the initial period immediately following his or her ceasing of employment on account of a disability must first be used against accumulated "sick leave" or "annual leave" prior to the employee being formally placed in disability retirement status.

Q-11: *What is permanent and total disability?*

A-11: It is the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that:

(a) Can be expected to result in death;

(b) Has lasted for a continuous period of not less than 12 months; or

(c) Can be expected to last for a continuous period of not less than 12 months. The substantial gainful activity referred to is not limited to the activity, or a comparable activity, in which the individual customarily engaged prior to such individual's retirement on disability.

See § 7.105-2 for additional information relating to substantial gainful activity.

Q-12: *If a taxpayer retired on disability but it is not clear until the following taxable year that the disability as of the date of such retirement was permanent and total (so that the employee did not exclude any amount as disability income in the earlier taxable year), may the taxpayer file an amended return to claim the disability income exclusion for the taxable year in which*

Internal Revenue Service, Treasury

§ 7.105-1

such taxpayer retired on disability which was permanent and total?

A-12: Yes.

Q-13: *What proof must a taxpayer furnish to establish the existence of permanent and total disability?*

A-13: If retired on disability before January 1, 1977: A certificate from a qualified physician attesting that—

(a) The taxpayer was permanently and totally disabled on January 1, 1976 or January 1, 1977; or

(b) The records of the Veterans Administration show that the taxpayer was permanently and totally disabled as defined in 38 CFR 3.340 or 3.342 on January 1, 1976 or January 1, 1977.

If retired on disability during 1977 or thereafter: A certificate from a qualified physician attesting that—

(a) The taxpayer was permanently and totally disabled on the date he or she retired; or

(b) The records of the Veterans Administration show that the taxpayer was permanently and totally disabled as defined in 38 CFR 3.340 or 3.342 on the date he or she retired.

In either case, the taxpayer must attach the certificate or a copy of the certificate to his or her income tax return. The certificate shall give the physician's name and address. No certificate from any employer is required with regard to the determination of permanent and total disability.

Q-14: *For what period does a taxpayer eligible (see Q-4) for the disability income exclusion (without regard to the \$15,000 income phaseout explained in Q-5) continue to be eligible for such exclusion?*

A-14: Unless the taxpayer earlier makes the irrevocable election not to claim the disability income exclusion described in Q-17 through Q-19, such taxpayer continues to be eligible until the earlier of:

(a) The beginning of the taxable year in which the taxpayer reaches age 65; and

(b) The day on which the taxpayer reaches mandatory retirement age.

Q-15: *May a taxpayer while eligible (see Q-4) for the disability income exclusion under the new law, exclude any applicable pension or annuity costs?*

A-15: No. This is true even though while eligible for the disability income exclusion, such taxpayer is unable to exclude any amount of the disability income payments because of the \$15,000 income phaseout (see Q-5).

Q-16: *When will a taxpayer who is eligible (see Q-4) to exclude disability income payments (without regard to the \$15,000 phaseout explained in Q-5) under the new law be able to exclude any applicable pension or annuity costs?*

A-16: In general, such a taxpayer will begin to exclude any of his or her pension or annuity costs under applicable rules of the Code

beginning on the first day of the taxable year in which he or she attains age 65 or, if mandatory retirement age is attained in an earlier taxable year, beginning on the day the taxpayer attains mandatory retirement age.

Q-17: *May a taxpayer who is eligible (see Q-4) to exclude disability income payments (without regard to the \$15,000 phaseout explained in Q-5) under the new law begin to exclude applicable pension or annuity costs in an earlier taxable year?*

A-17: Yes, but such a taxpayer must make the election described in Q-18 and Q-19 in which case the taxpayer would no longer be eligible for the disability income exclusion.

Q-18: *What is an election not to claim the disability income exclusion?*

A-18: It is an irrevocable election for the taxable year for which the election is made, and each taxable year thereafter. If such an election is made the taxpayer will begin to recover tax-free, out of the payments, his or her annuity costs as provided under the applicable provision of the Code.

Q-19: *How does a taxpayer who is eligible to exclude disability income payments (without regard to the \$15,000 phaseout explained in Q-5) under the new law make this election?*

A-19: The election is made by means of a statement attached to the taxpayer's income tax return (or amended return) for the taxable year in which the taxpayer wishes to have the applicable annuity rule apply. The statement shall set forth the taxpayers qualifications to make the election (i.e., that the taxpayer is eligible (see Q-4) to exclude disability income payments (without regard to the \$15,000 income phaseout explained in Q-5)) and that such taxpayer irrevocably elects not to claim the benefit of excluding disability income payments under section 105(d), as amended, for such taxable year and each taxable year thereafter. The election cannot be made for any taxable year beginning before January 1, 1976.

Q-20: *Did the changes made by the Tax Reduction and Simplification Act provide any relief to taxpayers eligible for the sick pay exclusion in taxable years beginning in 1976?*

A-20: Yes. As originally enacted, the more restrictive provisions of the disability income exclusion applied to taxable years beginning in 1976. The Tax Reduction and Simplification Act postponed the effective date of these provisions for 1 year. Thus, taxpayers may claim the sick pay exclusion in taxable years beginning in 1976.

(Secs. 105(d) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1566; 68A Stat. 917; 26 U.S.C. 105(d); 7805))

[T.D. 7450, 41 FR 56630, Dec. 29, 1976, as amended at 42 FR 2954, Jan. 14, 1977; T.D. 7544, 43 FR 19655, May 8, 1978]

§ 7.105-2 Substantial gainful activity.

(a) *Purpose.* This section defines substantial gainful activity for purposes of section 105(d) and § 7.105-1, prescribes rules for determining whether a taxpayer has the ability to engage in substantial gainful activity, and provides examples of the application of the definition and rules in specific factual situations.

(b) *Definition.* Substantial gainful activity is the performance of significant duties over a reasonable period of time in work for remuneration or profit (or in work of a type generally performed for remuneration or profit).

(c) *General rules.* (1) Full-time work under competitive circumstances generally indicates ability to engage in substantial gainful activity.

(2) Work performed in self-care or the taxpayer's own household tasks, and nonremunerative work performed in connection with hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities is not substantial gainful activity. However, the nature of the work performed may be evidence of ability to engage in substantial gainful activity.

(3) The fact that a taxpayer is unemployed for any length of time is not, of itself, conclusive evidence of inability to engage in substantial gainful activity.

(4) Regular performance of duties by a taxpayer in a full-time, competitive work situation at a rate of pay at or above the minimum wage will conclusively establish the taxpayer's ability to engage in substantial gainful activity. For purposes of paragraphs (c)(4) and (c)(5) of this section, the minimum wage is the minimum wage prescribed by section 6(a)(1) of the Fair Labor Standards Act of 1938, as amended, 29 U.S.C. 206(a)(1).

(5) Regular performance of duties by a taxpayer in a part-time, competitive work situation at a rate of pay at or above the minimum wage will conclusively establish the taxpayer's ability to engage in substantial gainful activity, if the duties are performed at the employer's convenience.

(6) In situations other than those described in paragraphs (c)(4) and (c)(5) of this section, other factors, such as the

nature of the duties performed, may establish a taxpayer's ability to engage in substantial gainful activity.

(d) *Examples.* The following examples illustrate the application of the definition in paragraph (b) of this section and the rules in paragraph (c) of this section in specific factual situations. In examples 1 through 5, the facts establish that the taxpayers are able to engage in substantial gainful activity and, therefore, are not entitled to claim the disability income exclusion of section 105(d). In examples 6 through 9, the facts do not, of themselves, establish the taxpayers' ability or inability to engage in substantial gainful activity. In these situations, all the facts and circumstances must be examined to determine whether the taxpayers are able to engage in substantial gainful activity.

Example (1). Before retirement on disability, taxpayer worked for a hotel as night desk clerk. After retirement, the taxpayer is hired by another hotel as night desk clerk at a rate of pay exceeding the minimum wage. Since the taxpayer regularly performs duties in a full-time competitive work situation at a rate of pay at or above the minimum wage, he or she is able to engage in substantial gainful activity.

Example (2). A taxpayer who retired on disability from employment as a sales clerk is employed as a full-time babysitter at a rate of pay equal to the minimum wage. Since the taxpayer regularly performs duties in a full-time, competitive work situation at a rate of pay at or above the minimum wage, he or she is able to engage in substantial gainful activity.

Example (3). A taxpayer retired on disability from employment as a teacher because of terminal cancer. The taxpayer's physician recommended continuing employment for therapeutic reasons and taxpayer accepted employment as a part-time teacher at a rate of pay in excess of the minimum wage. The part-time teaching work is done at the employer's convenience. Even though the taxpayer's illness is terminal, the employment was recommended for therapeutic reasons, and the work is part-time, the fact that the work is done at the employer's convenience demonstrates that the taxpayer is able to engage in substantial gainful activity.

Example (4). A taxpayer who retired on disability, is employed full-time in a competitive work situation that is less demanding than his or her former position. The rate of pay exceeds the minimum wage but is about half of the taxpayer's rate of pay in the

former position. It is immaterial that the new work activity is less demanding or less gainful than the work in which the taxpayer was engaged before his or her retirement on disability. Since the taxpayer regularly performs duties in a full-time, competitive work situation at a rate of pay at or above the minimum wage, he or she is able to engage in substantial gainful activity.

Example (5). A taxpayer who retired on disability from employment as a bookkeeper drives trucks for a charitable organization at the taxpayer's convenience. The taxpayer receives no compensation, but duties of this nature generally are performed for remuneration or profit. Some weeks the taxpayer works 10 hours, some weeks 40 hours, and over the year the taxpayer works an average of 20 hours per week. Even though the taxpayer receives no compensation, works part-time, and at his or her convenience, the nature of the duties performed and the average number of hours worked per week conclusively establish the taxpayer's ability to engage in substantial gainful activity.

Example (6). A taxpayer who retired on disability was instructed by a doctor that uninterrupted bedrest was vital to the treatment of his or her disability. However, because of financial need, the taxpayer secured new employment in a sedentary job. After attempting the new employment for approximately two months, the taxpayer was physically unable to continue the employment. The fact that the taxpayer attempted to work and did, in fact, work for two months, does not, of itself, conclusively establish the taxpayer's ability to engage in substantial gainful activity.

Example (7). A taxpayer who retired on disability accepted employment with a former employer on a trial basis. The purpose of the employment was to determine whether the taxpayer was employable. The trial period continued for an extended period of time and the taxpayer was paid at a rate equal to the minimum wage. However, because of the taxpayer's disability only light duties of a non-productive make-work nature were assigned. Unless the activity is both substantial and gainful, the taxpayer is not engaged in substantial gainful activity. The activity was gainful because the taxpayer was paid at a rate at or above the minimum wage. However, the activity was not substantial because the duties were of a nonproductive, make-work nature. Accordingly, these facts do not, of themselves, establish the taxpayer's ability to engage in substantial gainful activity.

Example (8). A taxpayer who retired on disability from employment as a bookkeeper lives with a relative who manages several motel units. The taxpayer assisted the relative for one or two hours a day by performing duties such as washing dishes, answering phones, registering guests, and

bookkeeping. The taxpayer can select the times during the day when he or she feels most fit to perform the tasks undertaken. Work of this nature, performed off and on during the day at the taxpayer's convenience, is not activity of a "substantial and gainful" nature even if the individual is paid for the work. The performance of these duties does not, of itself, show that the taxpayer is able to engage in substantial gainful activity.

Example (9). A taxpayer who retired on disability because of a physical or mental impairment accepts sheltered employment in a protected environment under an institutional program. Sheltered employment is offered in sheltered workshops, hospitals and similar institutions, homebound programs, and Veterans Administration domiciliaries. Typically, earnings are lower in sheltered employment than in commercial employment. Consequently, impaired workers normally do not seek sheltered employment if other employment is available. The acceptance of sheltered employment by an impaired taxpayer does not necessarily establish his or her ability to engage in substantial gainful activity.

(Secs. 105(d) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1566; 68A Stat. 917; 26 U.S.C. 105(d); 7805))

[T.D. 7544, 43 FR 19656, May 8, 1978]

§ 7.465-1 Amounts at risk with respect to activities begun prior to effective date; in general.

Section 465 provides that a taxpayer (other than a corporation which is not a subchapter S corporation or a personal holding company) engaged in certain activities may not deduct losses from such activity to the extent the losses exceed the amount the taxpayer is at risk with respect to the activity. For the types of activities to which section 465 applies and for determining what constitutes a separate activity, see section 465(c). Section 465 generally applies to losses attributable to amounts paid or incurred in taxable years beginning after December 31, 1975. For the purposes of applying the at risk limitation to activities begun before the effective date of the provision (and which were not excepted from application of the provision), it is necessary to determine the amount at risk as of the first day of the first taxable year beginning after December 31, 1975. The amount at risk in an activity as of the first day of the first taxable year of the taxpayer beginning after December

§ 7.465-2

31, 1975, (for the purposes of § 7.465-1 through 7.465-5 such first day shall be referred to as the effective date) shall be determined according to the rules provided in §§ 7.465-2 through 7.465-5.

[T.D. 7504, 42 FR 42197, Aug. 22, 1977]

§ 7.465-2 Determination of amount at risk.

(a) *Initial amount.* The amount a taxpayer is at risk on the effective date with respect to an activity to which section 465 applies shall be determined in accordance with this section. The initial amount the taxpayer is at risk in the activity shall be the taxpayer's initial basis in the activity as modified by disregarding amounts described in section 465(b) (3) or (4) (relating generally to amounts protected against loss or borrowed from related persons).

(b) *Succeeding adjustments.* For each taxable year ending before the effective date, the initial amount at risk shall be increased and decreased by the items which increased and decreased the taxpayer's basis in the activity in that year as modified by disregarding the amounts described in section 465(b) (3) or (4).

(c) *Application of losses and withdrawals.* (1) Losses described in section 465(d) which are incurred in taxable years beginning prior to January 1, 1976 and deducted in such taxable years, will be treated as reducing first that portion of the taxpayer's basis which is attributable to amounts not at risk. On the other hand, withdrawals made in taxable years beginning before January 1, 1976, will be treated as reducing the amount which the taxpayer is at risk.

(2) Therefore, if in a taxable year beginning prior to January 1, 1976 there is a loss described in section 465(d), it shall reduce the amount at risk only to the extent it exceeds the amount of the taxpayer's basis which is not at risk. For the purposes of this paragraph the taxpayer's basis which is not at risk is that portion of the taxpayer's basis in the activity (as of the close of the taxable year and prior to reduction for the loss) which is attributable to amounts described in section 465(b) (3) or (4).

(d) *Amount at risk shall not be less than zero.* If, after determining the amount described in paragraph (a), (b), and (c) of this section, the amount at risk (but

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

for this paragraph) would be less than zero, the amount at risk on the effective date shall be zero.

[T.D. 7504, 42 FR 42197, Aug. 22, 1977]

§ 7.465-3 Allocation of loss for different taxable years.

If the taxable year of the entity conducting the activity differs from that of the taxpayer, the loss attributable to the activity for the first taxable year of the entity ending after the beginning of the first taxable year of the taxpayer beginning after December 31, 1975, shall be allocated in the following manner. That portion of the loss from the activity for such taxable year of the entity which bears the same ratio as the number of days in such taxable year before January 1, 1976, divided by the total number of days in the taxable year, shall be attributable to taxable years of the taxpayer beginning before January 1, 1976. Consequently, that portion shall be treated in accordance with § 7.465-2.

[T.D. 7504, 42 FR 42198, Aug. 22, 1977]

§ 7.465-4 Insufficient records.

If sufficient records do not exist to accurately determine under § 7.465-2 the amount which a taxpayer is at risk on the effective date, the amount at risk shall be the taxpayer's basis in the activity reduced (but not below zero) by the taxpayer's share of amounts described in section 465(b) (3) or (4) with respect to the activity on the day before the effective date.

[T.D. 7504, 42 FR 42198, Aug. 22, 1977]

§ 7.465-5 Examples.

The provisions of § 7.465-1 and § 7.465-2 may be illustrated by the following examples:

Example (1). J and K, as equal partners, form partnership JK on January 1, 1975. Partnership JK is engaged solely in an activity described in section 465(c)(1). On January 1, 1975, each partner contributes \$10,000 in cash from personal assets to JK. On July 1, 1975, JK borrows \$40,000 (of which J's share is \$20,000) from a bank under a nonrecourse financing arrangement secured only by the new equipment (for use in the activity) purchased with the \$40,000. On September 1, 1975, JK reduces the amount due on the loan to \$36,000 (of which J's share is \$18,000). On October 1, 1975, JK distributes \$3,000 to each

Internal Revenue Service, Treasury

§ 7.936-1

partner. For taxable year 1975, JK has no income or loss. Although J's basis in the activity is \$25,000 (\$10,000+\$18,000-\$3,000) J's amount at risk on the effective date is \$7,000 determined as follows:

Initial amount at risk	\$10,000
Plus: Items which increased basis other than amounts described in sec. 465(b) (3) or (4)	0
Total	10,000
Less: Distribution	3,000
J's amount at risk on effective date	7,000

Example (2). Assume the same facts as in Example (1) except that JK has a loss (as described in section 465(d) for 1975 of which J's share is \$12,000. Although J's basis in the activity is \$13,000 (\$10,000+\$18,000-\$3,000+\$12,000)) J's amount at risk on the effective date is \$7,000 determined as follows:

Initial amount at risk	\$10,000
Plus: Items which increased basis other than amounts described in sec. 465(b) (3) or (4)	0
Total	10,000
Less: Distribution	3,000
Portion of loss (\$12,000) in excess of portion of basis not at risk (\$18,000)	0
Total	3,000
J's amount at risk on effective date	7,000

Example (3). Assume the same facts as in Example (1) except that JK has a loss (as described in section 465(d) for 1975, and J's share is \$23,000. J's basis in the activity is \$2,000 (\$10,000+\$18,000-\$3,000+\$23,000)). The amount at risk on the effective date is determined as follows:

Initial amount at risk	\$10,000
Plus: Items which increased basis other than amounts described in sec. 465(b) (3) or (4)	0
Total	10,000
Less: Distribution	3,000
Portion of loss (\$23,000) in excess of portion of basis not at risk (\$18,000)	5,000
Total	8,000
J's amount at risk on the effective date	2,000

[T.D. 7504, 42 FR 42198, Aug. 22, 1977]

§ 7.704-1 Partner's distributive share.

- (a)-(c) [Reserved]
- (d) *Limitation on allowance of losses.*
- (1)-(2) [Reserved]
- (3)(i) Section 213(e) of the Tax Reform Act of 1976 amended section 704(d) of the Internal Revenue Code relating to the deductions by partners of losses incurred by a partnership. A partner is entitled to deduct the share of partnership loss to the extent of the adjusted basis of the partner's interest in the

partnership. As amended, section 704(d) provides, in general, that the adjusted basis of a partner's interest in the partnership for the purpose of deducting partnership losses shall not include any portion of a partnership liability for which the partner has no personal liability. This restriction, however, does not apply to any activity to the extent that section 465 of the Code applies nor to any partnership whose principal activity is investing in real property, other than mineral property. Section 465 does not apply to corporations other than a subchapter S corporation or a personal holding company.

(ii) The restrictions in the amendment to section 704(d) will not apply to any corporate partner with respect to liabilities incurred in an activity described in section 465(c)(1). In all other respects the restrictions in the amendment will apply to all corporate partners unless the partnership's principal activity is investment in real property, other than mineral property.

[T.D. 7445, 41 FR 55344, Dec. 20, 1976]

§ 7.936-1 Qualified possession source investment income.

For purposes of this section, interest earned after September 30, 1976 (less applicable deductions), by a domestic corporation, engaged in the active conduct of a trade or business in Puerto Rico, which elects the application of section 936 with respect to deposits with certain Puerto Rican financial institutions will be treated as qualified possession source investment income within the meaning of section 936(d)(2) if (1) the interest qualifies for exemption from Puerto Rican income tax under regulations issued by the Secretary of the Treasury of Puerto Rico, as in effect on September 28, 1976, under the authority of section 2(j) of the Puerto Rico Industrial Incentive Act of 1963, as amended, (2) the interest is from sources within Puerto Rico (within the meaning of section 936(d)(2)(A)), and (3) the funds with respect to which the interest is earned are derived from the active conduct of a trade or business in Puerto Rico or from investment of funds so derived.

[T.D. 7452, 41 FR 56794, Dec. 30, 1976]

§7.999-1 Computation of the international boycott factor.

(a) *In general.* Sections 908(a), 952(a)(3), and 995(b)(1)(F) provide that certain benefits of the foreign tax credit, deferral of earnings of foreign corporations, and DISC are denied if a person or a member of a controlled group (within the meaning of section 993(a)(3)) that includes that person participates in or cooperates with an international boycott (within the meaning of section 999(b)(3)). The loss of tax benefits may be determined by multiplying the otherwise allowable tax benefits by the “international boycott factor.” Section 999(c)(1) provides that the international boycott factor is to be determined under regulations prescribed by the Secretary. The method of computing the international boycott factor is set forth in paragraph (c) of this section. A special rule for computing the international boycott factor of a person that is a member of two or more controlled groups is set forth in paragraph (d). Transitional rules for making adjustments to the international boycott factor for years affected by the effective dates are set forth in paragraph (e). The definitions of the terms used in this section are set forth in paragraph (b).

(b) *Definitions.* For purposes of this section:

(1) *Boycotting country.* In respect of a particular international boycott, the term “boycotting country” means any country described in section 999(a)(1) (A) or (B) that requires participation in or cooperation with that particular international boycott.

(2) *Participation in or cooperation with an international boycott.* For the definition of the term “participation in or cooperation with an international boycott”, see section 999(b)(3) and Parts H through M of the Treasury Department’s International Boycott Guidelines.

(3) *Operations in or related to a boycotting country.* For the definitions of the terms “operations”, “operations in a boycotting country”, “operations related to a boycotting country”, and “operations with the government, a company, or a national of a boycotting country”, see Part B of the Treasury

Department’s International Boycott Guidelines.

(4) *Clearly demonstrating clearly separate and identifiable operations.* For the rules for “clearly demonstrating clearly separate and identifiable operations”, see Part D of the Treasury Department’s International Boycott Guidelines.

(5) *Purchase made from a country.* The terms “purchase made from a boycotting country” and “purchases made from any country other than the United States” mean, in respect of any particular country, the gross amount paid in connection with the purchase of, the use of, or the right to use:

(i) Tangible personal property (including money) from a stock of goods located in that country,

(ii) Intangible property (other than securities) in that country,

(iii) Securities by a dealer to a beneficial owner that is a resident of that country (but only if the dealer knows or has reason to know the country of residence of the beneficial owner),

(iv) Real property located in that country, or

(v) Services performed in, and the end product of services performed in, that country (other than payroll paid to a person that is an officer or employee of the payor).

(6) *Sales made to a country.* The terms “sales made to a boycotting country” and “sales made to any country other than the United States” mean, in respect of any particular country, the gross receipts from the sale, exchange, other disposition, or use of:

(i) Tangible personal property (including money) for direct use, consumption, or disposition in that country,

(ii) Services performed in that country,

(iii) The end product of services (wherever performed) for direct use, consumption, or disposition in that country,

(iv) Intangible property (other than securities) in that country,

(v) Securities by a dealer to a beneficial owner that is a resident of that country (but only if the dealer knows or has reason to know the country of residence of the beneficial owner), or

(vi) Real property located in that country.

To determine the country of direct use, consumption, or disposition of tangible personal property and the end product of services, see paragraph (b)(10) of this section.

(7) *Sales made from a country.* The terms “sales made from a boycotting country” and “sales made from any country other than the United States” mean, in respect of a particular country, the gross receipts from the sale, exchange, other disposition, or use of:

(i) Tangible personal property (including money) from a stock of goods located in that country,

(ii) Intangible property (other than securities) in that country, or

(iii) Services performed in, and the end product of services performed in, that country.

However, gross receipts from any such sale, exchange, other disposition, or use by a person that are included in the numerator of that person’s international boycott factor by reason of paragraph (b)(6) of this section shall not again be included in the numerator by reason of this subparagraph.

(8) *Payroll paid or accrued for services performed in a country.* The terms “payroll paid or accrued for services performed in a boycotting country” and “payroll paid or accrued for services performed in any country other than the United States” mean, in respect of a particular country, the total amount paid or accrued as compensation to officers and employees, including wages, salaries, commissions, and bonuses, for services performed in that country.

(9) *Services performed partly within and partly without a country—(i) In general.* Except as provided in paragraph (b)(9)(ii) of this section, for purposes of allocating to a particular country:

(A) The gross amount paid in connection with the purchase or use of,

(B) The gross receipts from the sale, exchange, other disposition or use of, and

(C) The payroll paid or accrued for services performed, or the end product of services performed, partly within and partly without that country, the amount paid, received, or accrued to be allocated to that country, unless the

facts and circumstances of a particular case warrant a different amount, will be that amount that bears the same relation to the total amount paid, received, or accrued as the number of days of performance of the services within that country bears to the total number of days of performance of services for which the total amount is paid, received, or accrued.

(ii) *Transportation, telegraph, and cable services.* Transportation, telegraph, and cable services performed partly within one country and partly within another country are allocated between the two countries as follows:

(A) In the case of a purchase of such services performed from Country A to Country B, fifty percent of the gross amount paid is deemed to be a purchase made from Country A and the remaining fifty percent is deemed to be a purchase made from Country B.

(B) In the case of a sale of such services performed from Country A to Country B, fifty percent of the gross receipts is deemed to be a sale made from Country A and the remaining fifty percent is deemed to be a sale made to Country B.

(10) *Country of use, consumption, or disposition.* As a general rule, the country of use, consumption, or disposition of tangible personal property (including money) and the end product of services (wherever performed) is deemed to be the country of destination of the tangible personal property or the end product of the services. (Thus, if legal services are performed in one country and an opinion is given for use by a client in a second country, the end product of the legal services is used, consumed, or disposed of in the second country.) The occurrence in a country of a temporary interruption in the shipment of the tangible personal property or the delivery of the end product of services shall not constitute such country the country of destination. However, if at the time of the transaction the person providing the tangible personal property or the end product of services knew, or should have known from the facts and circumstances surrounding the transaction, that the tangible personal property or the end product of services probably would not be used, consumed,

or disposed of in the country of destination, that person must determine the country of ultimate use, consumption or disposition of the tangible personal property or the end product of services. Notwithstanding the preceding provisions of this subparagraph, a person that sells, exchanges, otherwise disposes of, or makes available for use, tangible personal property to any person all of whose business except for an insubstantial part consists of selling from inventory to retail customers at retail outlets all within one country may assume at the time of such sale to such person that the tangible personal property will be used, consumed, or disposed of within such country.

(11) *Controlled group taxable year.* The term “controlled group taxable year” means the taxable year of the controlled group’s common parent corporation. In the event that no common parent corporation exists, the members of the group shall elect the taxable year of one of the members of the controlled group to serve as the controlled group taxable year. The taxable year election is a binding election to be changed only with the approval of the Secretary of his delegate. The election is to be made in accordance with the procedures set forth in the instructions to Form 5713, the International Boycott Report.

(c) *Computation of international boycott factor*—(1) *In general.* The method of computing the international boycott factor of a person that is not a member of a controlled group is set forth in paragraph (c)(2) of this section. The method of computing the international boycott factor of a person that is a member of a controlled group is set forth in paragraph (c)(3) of this section. For purposes of paragraphs (c) (2) and (3), purchases and sales made by, and payroll paid or accrued by, a partnership are deemed to be made or paid or accrued by a partner in that proportion that the partner’s distributive share bears to the purchases and sales made by, and the payroll paid or accrued by, the partnership. Also for purposes of paragraphs (c) (2) and (3), purchases and sales made by, and payroll paid or accrued by, a trust referred to in section 671 are deemed to be made both by the trust (for purposes of determining

the trust’s international boycott factor), and by a person treated under section 671 as the owner of the trust (but only in that proportion that the portion of the trust that such person is considered as owning under sections 671 through 679 bears to the purchases and sales made by, and the payroll paid and accrued by, the trust).

(2) *International boycott factor of a person that is not a member of a controlled group.* The international boycott factor to be applied by a person that is not a member of a controlled group (within the meaning of section 993(a)(3)) is a fraction.

(i) The numerator of the fraction is the sum of the—

(A) Purchases made from all boycotting countries associated in carrying out a particular international boycott.

(B) Sales made to or from all boycotting countries associated in carrying out a particular international boycott, and

(C) Payroll paid or accrued for services performed in all boycotting countries associated in carrying out a particular international boycott by that person during that person’s taxable year, minus the amount of such purchases, sales, and payroll that is clearly demonstrated to be attributable to clearly separate and identifiable operations in connection with which there was no participation in or cooperation with that international boycott.

(ii) The denominator of the fraction is the sum of the—

(A) Purchases made from any country other than the United States,

(B) Sales made to or from any country other than the United States, and

(C) Payroll paid or accrued for services performed in any country other than the United States by that person during that person’s taxable year.

(3) *International boycott factor of a person that is a member of a controlled group.* The international boycott factor to be applied by a person that is a member of a controlled group (within the meaning of section 993(a)(3)) shall be computed in the manner described in paragraph (c)(2) of this section, except that there shall be taken into account the purchases and sales made by, and the payroll paid or accrued by,

each member of the controlled group during each member's own taxable year that ends with or within the controlled group taxable year that ends with or within that person's taxable year.

(d) *Computation of the international boycott factor of a person that is a member of two or more controlled groups.* The international boycott factor to be applied under sections 908(a), 952(a)(3), and 995(b)(1)(F) by a person that is a member of two or more controlled groups shall be determined in the manner described in paragraph (c)(3), except that the purchases, sales, and payroll included in the number and denominator shall include the purchases, sales, and payroll of that person and of all other members of the two or more controlled groups of which that person is a member.

(e) *Transitional rules—(1) Pre-November 3, 1976 boycotting operations.* The international boycott factor to be applied under sections 908(a), 952(a)(3), and 995(b)(1)(F) by a person that is not a member of a controlled group, for that person's taxable year that includes November 3, 1976, or a person that is a member of a controlled group, for the controlled group taxable year that includes November 3, 1976, shall be computed in the manner described in paragraphs (c)(2) and (c)(3), respectively, of this section. However, that the following adjustments shall be made:

(i) There shall be excluded from the numerators described in paragraphs (c)(2)(i) and (c)(3)(i) of this section purchases, sales, and payroll clearly demonstrated to be attributable to clearly separate and identifiable operations—

(A) That were completed on or before November 3, 1976, or

(B) In respect of which it is demonstrated that the agreements constituting participation in or cooperation with the international boycott were renounced, the renunciations were communicated on or before November 3, 1976, to the governments or persons with which the agreements were made and the agreements have not been reaffirmed after November 3, 1976, and

(ii) The international boycott factor resulting after the numerator has been modified in accordance with paragraph (e)(1)(i) of this section shall be further modified by multiplying it by a frac-

tion. The numerator of that fraction shall be the number of days in that person's taxable year (or, if applicable, in that person's controlled group taxable year) remaining after November 3, 1976, and the denominator shall be 366.

The principles of this subparagraph are illustrated in the following example:

Example. Corporation A, a calendar year taxpayer, is not a member of a controlled group. During the 1976 calendar year, Corporation DA had three operations in a boycotting country under three separate contracts, each of which contained agreements constituting participation in or cooperation with an international boycott. Each contract was entered into on or after September 2, 1976. Operation (1) was completed on November 1, 1976. The sales made to a boycotting country in connection with Operation (1) amounted to \$10. Operation (2) was not completed during the taxable year, but on November 1, 1976, Corporation A communicated a renunciation of the boycott agreement covering that operation to the government of the boycotting country. The sales made to a boycotting country in connection with Operation (2) amounted to \$40. Operation (3) was not completed during the taxable year, nor was any renunciation of the boycott agreement made. The sales made to a boycotting country in connection with Operation (3) amounted to \$25. Corporation A had no purchases made from, sales made from, or payroll paid or accrued for services performed in, a boycotting country. Corporation A had \$500 of purchases made from, sales made from, sales made to, and payroll paid or accrued for services performed in, countries other than the United States. Company A's boycott factor for 1976, computed under paragraph (c)(2) of this section (before the application of this subparagraph) would be:

$$(\$10 + \$40 + \$25) / \$500 = (\$75 / \$500)$$

However, the \$10 is eliminated from the numerator by reason of paragraph (e)(1)(i)(A) of this section, and the \$40 is eliminated from the numerator by reason of paragraph (e)(1)(i)(B) of this section. Thus, before the application of paragraph (e)(1)(ii) of this section, Corporation A's international boycott factor is \$25/\$500. After the application of paragraph (e)(1)(ii), Corporation A's international boycott factor is:

$$(\$25 / \$500) \times (58 / 366)$$

(2) *Pre-December 31, 1977 boycotting operations.* The international boycott factor to be applied under sections 908(a), 952(a)(3), and 995(b)(1)(F) by a person that is not a member of a controlled

group, for that person's taxable year that includes December 31, 1977, or by a person that is a member of a controlled group, for the controlled group taxable year that includes December 31, 1977, shall be computed in the manner described in paragraphs (c)(2) and (c)(3), respectively, of this section. However, the following adjustments shall be made:

(i) There shall be excluded from the numerators described in paragraphs (c)(2)(i) and (c)(3)(i) of this section purchases, sales, and payroll clearly demonstrated to be attributable to clearly separate and identifiable operations that were carried out in accordance with the terms of binding contracts entered into before September 2, 1976, and—

(A) That were completed on or before December 31, 1977, or

(B) In respect of which it is demonstrated that the agreements constituting participation in or cooperation with the international boycott were renounced, the renunciations were communicated on or before December 31, 1977, to the governments or persons with which the agreements were made, and the agreements were not reaffirmed after December 31, 1977, and

(ii) In the case of clearly separate and identifiable operations that are carried out in accordance with the terms of binding contracts entered into before September 2, 1976, but that do not meet the requirements of paragraph (e)(2)(i) of this section, the numerators described in paragraphs (c)(2)(i) and (c)(3)(i) of this section shall be adjusted by multiplying the purchases, sales, and payroll clearly demonstrated to be attributable to those operations by a fraction, the numerator of which is the number of days in such person's taxable year (or, if applicable, in such person's controlled group taxable year) remaining after December 31, 1977, and the denominator of which is 365.

The principles of this subparagraph are illustrated in the following example:

Example. Corporation A is not a member of a controlled group and reports on the basis of a July 1-June 30 fiscal year. During the 1977-1978 fiscal year, Corporation A had 2 operations carried out pursuant to the terms of separate contracts, each of which had a

clause that constituted participation in or cooperation with an international boycott. Neither operation was completed during the fiscal year, nor were either of the boycotting clauses renounced. Operation (1) was carried out in accordance with the terms of a contract entered into on November 15, 1976. Operation (2) was carried out in accordance with the terms of a binding contract entered into before September 2, 1976. Corporation A had sales made to a boycotting country in connection with Operation (1) in the amount of \$50, and in connection with Operation (2) in the amount of \$100. Corporation A had sales made to countries other than the United States in the amount of \$500. Corporation A had no purchases made from, sales made from, or payroll paid or accrued for services performed in, any country other than the United States. In the absence of this subparagraph, Corporation A's international boycott factor would be

$$(\$50 + \$100) / \$500.$$

However, by reason of the application of this subparagraph, Corporation A's international boycott factor is reduced to

$$[(\$50 + \$100)(181 / 365)] / \$500$$

(3) *Incomplete controlled group taxable year.* If, at the end of the taxable year of a person that is a member of a controlled group, the controlled group taxable year that includes November 3, 1976 has not ended, or the taxable year of one or more members of the controlled group that includes November 3, 1976 has not ended, then the international boycott factor to be applied under sections 908(a), 952(a)(3) and 995(b)(1)(F) by such person for the taxable year shall be computed in the manner described in paragraph (c)(3) of this section. However, the numerator and the denominator in that paragraph shall include only the purchases, sales, and payroll of those members of the controlled group whose taxable years ending after November 3, 1976 have ended as the end of the taxable year of such person.

(f) *Effective date.* This section applies to participation in or cooperation with an international boycott after November 3, 1976. In the case of operations which constitute participation in or cooperation with an international boycott and which are carried out in accordance with the terms of a binding contract entered into before September

Internal Revenue Service, Treasury

§ 7.6041-1

2, 1976, this section applies to such participation or cooperation after December 31, 1977.

[T.D. 7467, 42 FR 11833, Mar. 1, 1977]

§ 7.6039A-1 Information regarding carryover basis property acquired from a decedent.

(a) *Information for Internal Revenue Service.* In the case of a decedent who dies after December 31, 1976, the executor (as defined in section 2203) shall furnish to the Internal Revenue Service the following information, as applicable—

(1) If an estate tax return is required to be filed under section 6018 of the Internal Revenue Code of 1954, as amended, and if the return form contains questions relating to carryover basis property, the executor must answer those questions.

(2) If no estate tax return is required to be filed under section 6018 of the Internal Revenue Code of 1954, as amended, or if a return is required to be filed but the return form used does not contain questions relating to carryover basis property, the executor must file the form prescribed by the Commissioner. This form may be attached to the estate tax return or the decedent's final individual income tax return. If this form is not attached to the estate tax return or the decedent's final individual income tax return, it must be filed with the Internal Revenue Service office where the decedent's final income tax return would be filed if one were required within 9 months after the date of the decedent's death or by December 31, 1978, whichever is later.

(b) *Information to be furnished to beneficiaries.* Any executor required under paragraph (a) of this section to furnish information to the Internal Revenue Service relating to carryover basis property must furnish in writing to the distributee of each piece of carryover basis property—

(1) A description of the property,

(2) The adjusted basis of the property as computed under section 1023 (a), (c), and (d),

(3) The amount of the increase in the basis of the property determined under section 1023(h),

(4) The value of the property for Federal estate tax purposes, and

(5) A notice that the beneficiary should keep this information as part of permanent records.

(c) *Time for furnishing information to beneficiaries.* The information which an executor is required to furnish to the beneficiaries under this paragraph must be furnished on or before the latest of—

(1) The date the property is distributed to the beneficiary,

(2)(i) In the case of an executor who is required to file an estate tax return, 6 months after the due date (including extensions) of such return,

(ii) In the case of an executor who is not required to file an estate tax return, 15 months from the date of death of the decedent, or

(3) December 31, 1978.

(d) *Subsequent adjustments to carryover basis.* In the event subsequent adjustments are made which relate to the carryover basis of any piece of property included in a decedent's gross estate, whether by reason of an adjustment resulting from an examination of the estate tax return or otherwise, any executor required under paragraph (a) of this section to furnish information to the Internal Revenue Service shall, within 3 months of a determination, as defined in section 1313 (a), of such adjustments, provide to the recipient of each item of carryover basis property the information set forth in paragraph (b) of this section recomputed as required by such adjustments.

(e) *Effective date.* This section is effective in respect of decedents dying after December 31, 1976.

(Secs. 7805 and 6039A of the Internal Revenue Code of 1954 (68A Stat. 917, 90 Stat. 1878; 26 U.S.C. 7805, 6039A))

[T.D. 7540, 43 FR 16735, Apr. 20, 1978, as amended by T.D. 7559, 43 FR 36244, Aug. 16, 1978]

§ 7.6041-1 Return of information as to payments of winnings from bingo, keno, and slot machines.

(a) *In general.* On or after May 1, 1977, every person engaged in a trade or business and making a payment in the course of such trade or business of winnings (including winnings which are exempt from withholding under section 3402(q)(5)) of \$1,200 or more from a bingo game or slot machine play or of

\$1,500 or more from a keno game shall make an information return with respect to such payment.

(b) *Special rules.* For purposes of paragraph (a) of this section, in determining whether such winnings equal or exceed the \$1,200 or \$1,500 amount—

(1) In the case of a bingo game or slot machine play, the amount of winnings shall not be reduced by the amount wagered;

(2) In the case of a keno game, the amount of winnings from one game shall be reduced by the amount wagered in that one game;

(3) Winnings shall include the fair market value of a payment in any medium other than cash;

(4) All winnings by the winner from one bingo or keno game shall be aggregated; and

(5) Winnings and losses from any other wagering transaction by the winner shall not be taken into account.

(c) *Prescribed form.* The return required by paragraph (a) of this section shall be made on Form W-2G and shall be filed with the Internal Revenue Service Center serving the district in which is located the principal place of business of the person making the return on or before February 28 of the calendar year following the calendar year in which the payment of winnings is made. Each Form W-2G shall contain the following:

(1) Name, address, and employer identification number of the person making the payment;

(2) Name, address, and social security number of the winner;

(3) General description of two types of identification (*e.g.*, “driver’s license”, “social security card”, or “voter registration card”) furnished to the maker of the payment for verification of the winner’s name, address, and social security number;

(4) Date and amount of the payment; and

(5) Type of wagering transaction.

In addition, in the case of a bingo or keno game, Form W-2G shall show any number, color, or other designation assigned to the game with respect to which the payment is made. In the case of a slot machine play, Form W-2G

shall show the identification number of the slot machine.

[T.D. 7457, 42 FR 1471, Jan. 7, 1977, as amended by T.D. 7492, 42 FR 33286, June 30, 1977]

PART 8—TEMPORARY INCOME TAX REGULATIONS UNDER SECTION 3 OF THE ACT OF OCTOBER 26, 1974 (PUB. L. 93-483)

AUTHORITY: Secs. 2055(e)(3) and 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

§ 8.1 Charitable remainder trusts.

(a) *Certain wills and trusts in existence on September 21, 1974.* In the case of a will executed before September 21, 1974, or a trust created (within the meaning of applicable local law) after July 31, 1969, and before September 21, 1974, which is amended pursuant to section 2055(e)(3) and § 24.1 of this chapter (Temporary Estate Tax Regulations), a charitable remainder trust resulting from such amendment will be treated as a charitable remainder trust from the date it would be deemed created under § 1.664-1(a) (4) and (5) of this chapter (Income Tax Regulations), whether or not such date is after September 20, 1974.

(b) *Certain transfers to trusts created before August 1, 1969.* Property transferred to a trust created (within the meaning of applicable local law) before August 1, 1969, whose governing instrument provides that an organization described in section 170(c) receives an irrevocable remainder interest in such trust shall be deemed transferred to a trust created on the date of such transfer, provided that the transfer occurs after July 31, 1969 and prior to October 18, 1971, and pursuant to an amendment provided in § 24.1 of this chapter (Temporary Estate Tax Regulations), the transferred property and any undistributed income therefrom is severed and placed in a separate trust as of the date of the amendment.

[T.D. 7393, 40 FR 58853, Dec. 19, 1975]