NO. 19-73078

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PATIENTS MUTUAL ASSISTANCE COLLECTIVE CORPORATION D.B.A
HARBORSIDE HEALTH CENTER,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

On Appeal from the United States Tax Court
Nos.: 2912-11; 30851-12; 14766-14
Hon. Mark V. Holmes

OPENING BRIEF FOR APPELLANT

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Fed. R. App. P. 26.1 and Fed R. App. P. 28(a)(1), Appellant, Patients Mutual Assistance Collective Corporation d.b.a. Harborside Health Center ("Harborside"), states that it has no parent corporation and that no publicly held corporation owns 10% or more of its stock.

Dated: May 26, 2020

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JURISDICTIONAL STATEMENT

This case is an appeal from the October 17, 2019 decision of the United States Tax Court (the "Tax Court"), in which it ordered and decided that there are deficiencies in income tax due from Harborside for 2007, 2008, 2009, 2010, 2011, and 2012. The Tax Court exercised jurisdiction pursuant to I.R.C. § 6213, and the decision of the Tax Court is final and appealable pursuant to I.R.C. § 7481. This Court has jurisdiction to consider this appeal pursuant to I.R.C. § 7482(a)(1). Harborside timely field a notice of appeal on December 2, 2019 pursuant to I.R.C. § 7483. II ER 76.

ISSUES PRESENTED

(1) Does § 280E of the Internal Revenue Code violate the Sixteenth Amendment of the Constitution of the United States because it is not a tax on income?

(2) Should taxpayer be free to determine its cost of goods sold in the same fashion as other similar businesses?

An Addendum containing the pertinent constitutional provisions, statutes and regulations is annexed to this brief.

STATEMENT OF THE CASE

I. Factual Background

Serving thousands of patients and generating millions of dollars of revenue annually, Harborside has grown to be one of the largest cannabis dispensaries in the United States since being founded in 2005. I ER 17–18. While cannabis remains a schedule I controlled substance under federal law, an increasing number of states have opened up medical and recreational cannabis markets. I ER 16, 31. California authorized the collective cultivation of medical cannabis with the passage of the 2003 Medical Marijuana Program Act. I ER 16–17, 28. As a result, medical cannabis dispensaries, operating under the collective cultivation model, began to spring up in California in the early to mid-2000s. I ER 16–17.

In this new frontier, Harborside was founded with the vision of becoming the "gold standard" for the industry as a whole. I ER 17. For Harborside, achieving this "gold standard" meant, in large part, ensuring it complied with state laws. I ER 13. California required

> that medical-marijuana cooperatives should be formally organized, not operate for profit, maintain business licenses and permits, pay tax, verify each member's status as a patient, execute an agreement with each member regarding the use and distribution of marijuana, keep records of distribution, and neither buy marijuana from nor distribute marijuana to nonmembers.

I ER 28–29. As a result, Harborside operated and was taxed as a non-profit – at least by California. I ER 23–24. For federal tax purposes, however, Harborside files and is treated as a C corporation. [1] *Id.*

The products that Harborside sold to its patient-members can roughly be divided into four categories: marijuana flowers, marijuana-containing products, clones, and non-marijuana containing products. I ER 19. The expenses involved in acquiring and processing these four types of products are the "cost of goods sold" that are the heart of this case — Harborside believes that many of these expenses are part of acquiring inventory and preparing it for sale but the Tax Court disagrees.

[1] "[T]o comply with California's nonprofit requirement, [Harborside's] bylaws prohibited it from paying dividends or selling equity, and required it to use any excess revenue for the benefit of its patients or the community." I ER 23–24 (footnote omitted).

The first kind of product Harborside sold was marijuana flower. *Id.* Harborside did not grow any of the marijuana flower it sold. I ER 19–21. Rather, all of the marijuana flower Harborside sold was purchased by Harborside from its members. *Id.* When a member wanted to sell marijuana flower to Harborside, Harborside would require the member to enter into a cultivation agreement. *Id.* Then, Harborside would conduct an initial inspection of the marijuana in its purchasing office.[2]

Harborside helped its patients find specific strains of cannabis for particular medical problems. II ER 136. Not only were there important differences among the forms of cannabis to be given to the patient, the ratio between THC (psychoactive) and CBD (therapeutic but non-psychoactive) chemicals varied from strain to strain, and even from batch to batch.[3] II ER 136–37. For example, children being treated for

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[2] "At all relevant times Harborside operated out of an approximately 7,500-square-foot space that had a reception area, healing room, purchasing office, processing room, clone room, and multipurpose room. The facility also had a large sales floor, offices, storage areas, restrooms, and a break room with a kitchen." I ER 18; II ER 110.

[3] A cannabinoid is any of a group of closely related compounds which include cannabinol and the active constituents of cannabis. Albert

seizures from "intractable childhood epilepsy" need strains that are rich in CBD but low in THC. II ER 135–36. The co-founder of Harborside testified that, as a result:

> [T]here have been times when we needed very precise cannabinoid profiles. And so essentially we go on a cannabinoid hunt and really be very, very proactive. And contact dispensaries all over the state. Contact growers that we knew all over the state and really put out the call that a particular needs [sic] has developed for a certain cannabinoid profile.

I ER 137.

If satisfied, Harborside would purchase the marijuana flower from the seller at a price "based on its weight, quality, and market factors." III ER 225. After purchasing, there was a three-stage quality control process. First, personnel at Harborside would use microscopes to identify the strain and check for contaminants. II ER140–141.

Second, Harborside would then pay a third-party laboratory to test a representative sample of the marijuana flower. I ER 21. The lab would test the sample to determine its cannabinoid profile and to screen

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Weissman, *On the Definition of Cannabinoids: Botanical? Chemical? Pharmacological?*, J. Clinical Pharmacology 159 (1981).

it for safety issues, such as pathogenic mold. I ER 20; II ER 163; III ER 226.

Third, Harborside sent out the cannabis to a different laboratory that "conducts an analysis of pathogenic mold spores in the sample." II ER 141–142.

If the sample met Harborside's standards, the marijuana flower that the sample was representative of "would go to a processing room where it was reinspected, remanicured, retrimmed, and then weighed, packaged, and labeled." I ER 19–21.

Occasionally, the cannabis required curing before being processed—"if the cannabis had a suboptimal moisture profile . . . we used a variety of techniques to adjust that moisture profile," which involved "putting the cannabis in various different containers with . . . hydrogenating substances or desiccating substances." II ER 166.

After processing, the marijuana would either be housed in the vault, if in storage, or on the sales floor, if for sale. I ER 19–21. The vault was a concrete room made of reinforced concrete at least twelve, and in some places, eighteen, inches thick. II ER 151. The vault door was a bank vault type door about twelve inches thick with biometric locks that recorded identity and time of every entrant. *Id.*

During the years at issue, "Harborside had at least three employees dedicated to acquiring [marijuana flower], at least four devoted to managing [marijuana flower], and still others whose sole job it was to process the bulk marijuana [flower] and ready it for resale." I ER 19–21. The processing employees trimmed and manicured the product as needed and then put it into individual retail packages. II ER 157. Harborside marketed itself as the "home of the naked bud" so there was a final close inspection and possibly further trimming and manicuring. II ER 158. At that point every item was barcoded and subject to a custom-created secure chain of custody system. II ER 157.

Harborside believes that the costs of the personnel involved in finding the cannabinoids, the costs of the three stages of quality control, the costs of curing, the security costs for storing and guarding the inventory, and the costs of the employees trimming, manicuring and packaging the cannabis are properly allocable to the cost of goods sold since they are necessary to acquire, store and process the inventory to bring it to sale.

The second kind of product Harborside sold was marijuana-containing products. I ER 19–22. These "products included edibles, beverages, extracts, concentrates, oils, topicals, and tinctures." I ER 21. Harborside did not manufacture any of these products, but instead bought them from other collectives. I ER 21–22. However, Harborside would test, relabel, and sometimes repackage[4] these products before selling them. *Id.* Many of the edible products and some of the beverages were stored in special freezers. II ER 153.

Harborside believes that the costs of testing, relabeling, repackaging, and storing these products in special freezers are properly allocable to the cost of goods sold since they are necessary to acquire, store and process the inventory to bring it to sale.

The third kind of product Harborside sold was "live marijuana plant trimmings ('clones')." I ER 19–22. "Clones are cuttings from a female cannabis plant that can be transplanted and used to cultivate marijuana." I ER 19. As with marijuana flower, Harborside did not grow the clones that it sold. I ER 19; III ER 226–227. Rather,

[4] Harborside would repackage these products "if they came in bulk or needed child-proof packaging." I ER 21–22.

"Harborside bought clones from clone nurseries[.]" I ER 19. Clones are living plants that need to be cared for in exacting ways:

> [T]hey need to be brought specifically and quickly into a designated area. That area needs to be maintained at a specific temperature, atmosphere conditions under certain kinds of lights. They need to be fed on a regular basis and monitored for any type of pest of mold infestations. . . . And then there's a pretty detailed packaging process as well to make sure that when they leave our facilities they're in a form and in a package so they don't get destroyed on a three, four-hour drive back up to the grove site.

II ER 144. "During the years at issue Harborside had at least four employees who spent their time entirely in the purchase and sale of clones." I ER 19.

Harborside believes that the costs of the personnel involved in purchasing and the costs of maintaining the live plants are properly allocable to the cost of goods sold since they are necessary to acquire, store and process the inventory to bring it to sale.

The fourth and final kind of product Harborside sold were non-marijuana containing products. I ER 22. Products included items such as clothing, books, and assorted marijuana accessories. *Id.*

Harborside's commitment to achieving the "gold standard" extended beyond how it managed its inventory, customers, and employees to how it prepared its tax returns. I ER 13. In preparing its tax returns for the years at issue (and for the amended returns for 2007, 2008, and 2009), Harborside sought expert accounting advice and made a voluntary attempt to perform an allocation of expenses and not claim as a deduction those that appeared to be related to "trafficking." II ER 175–179. In doing so, Harborside used a precise method of measuring square footage and employee time to determine what was nondeductible. II ER 148, 172, 175–79.

Further, Harborside kept good books and records. I ER 12. Indeed, "[k]eeping good books and records was one of Harborside's strengths." *Id.* All this, coupled with the lack of guidance from the IRS,[5] led the Tax Court to find that Harborside "acted with reasonable cause and in good faith when taking its tax positions for the years at issue." I ER 13.

For each of the years at issue, 2007 to 2012, Harborside filed a Form 1120, U.S. Corporation Income Tax Return.[6] I ER 26; III ER 236–

[5] "[T]he IRS has never promulgated regulations for § 280E and didn't issue any guidance on marijuana businesses' capitalization of inventory costs until 2015." I ER 11.

[6] The 2007, 2008, and 2009 returns were later amended, I ER 26, and all references to the 2007, 2008, and 2009 returns herein refer to the amended returns.

276. Each return properly reflected Harborside's gross receipts, total deductions, and total cost of goods sold for each year. III ER 232–234. Harborside's returns showed:

TABLE I -- TAX RETURNS

Year	Revenue	Cost of Purchases	Other Items Claimed in Cost of Goods Sold	Expenses
2007	$ 5,449,122	$ 3,844,671	$ 80,018	$ 1,905,256
2008	$ 10,920,904	$ 6,602,218	$ 384,998	$ 3,395,093
2009	$ 17,351,475	$11,114,965	$1,095,178	$ 5,238,699
2010	$ 22,089,864	$13,753,995	$1,022,240	$ 6,716,779
2011	$ 20,954,411	$11,846,707	$1,044,857	$ 7,750,908
2012	$ 25,520,648	$13,816,278	$3,668,080	$ 6,568,224

III ER 234.[7]

The IRS selected Harborside's returns for the above years for audit, issuing three notices of deficiency—one for 2007 and 2008, one for 2009 and 2010, and one for 2011 and 2012. IV ER 424–444, 449–469, 475–502. These notices denied most of Harborside's claimed deductions[8]

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[7] "The parties disagree as to the proper characterization of the 'Other Items Claimed in Cost of Goods Sold' and 'Expenses' as inventory costs, deductible expenses, or non-deductible business expenses." III ER 235.
[8] *See* notes 11, 12, and 13.

and costs of goods sold,[9] asserting tens of millions of dollars in deficiencies and accuracy-related penalties.[10] *Id.*

For 2007 and 2008, the Commissioner determined a deficiency in income tax in the amounts of $628,516.00 and $1,387,199.00, respectively.[11] IV ER 475. For 2009 and 2010, the Commissioner determined a deficiency in income tax in the amounts of $6,013,658.00 and $7,409,470.00, respectively.[12] IV ER 449. For 2011 and 2012, the Commissioner determined a deficiency in income tax in the amounts of $7,184,077.00, and $7,151,506.00, respectively.[13] IV ER 425.

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[9] *See* notes 11, 12, and 13.

[10] The Tax Court ultimately held that Harborside was not subject to any accuracy-related penalties because Harborside "acted with reasonable cause and in good faith when taking its tax positions for the years at issue." I ER 13; *infra*, at 23.

[11] For 2007 and 2008, the Commissioner made adjustments to income in the amounts of $2,130,554.00 and $4,136,255.00, respectively. IV ER 479. This included adjustments to cost of goods sold in the amount of ($3,155,485.00) and $258,750.00 for 2007 and 2008, respectively. IV ER 481; *see also* IV ER 489–502 for itemized list of denied deductions.

[12] For 2009 and 2010, the Commissioner made adjustments to income in the amounts of $17,232,131.00 and $21,148,327.00, respectively. IV ER 453. This included adjustments to cost of goods sold in the amount of $11,943,352.00 and $14,508,909.00 for 2009 and 2010, respectively. IV ER 455; *see also* IV ER 457–471 for itemized list of denied deductions.

[13] For 2011 and 2012, the Commissioner made adjustments to income in the amounts of $20,512,128.00 and $20,383,662.00, respectively. IV ER

The Commissioner's asserted basis for denying Harborside's claimed deductions was § 280E of the Internal Revenue Code:

> No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on a trade or business that consists of trafficking in controlled substances (within the meaning of schedule I or II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business was conducted.

See IV ER 441–444, 457–471, 489–502.

II. Procedural History

Harborside petitioned the Tax Court for a redetermination of the deficiencies asserted by the Commissioner. IV ER 446–447, 472–473. The first petition was filed on December 20, 2011 for 2007–2008. IV ER 472. Subsequently, petitions related to the 2009–2010 and 2011–2012 were filed on December 26, 2012 and June 24, 2014, respectively. IV ER 421, 445. All three cases were eventually consolidated for trial, briefing, and opinion on April 7, 2015.[14] IV ER 417–20, 445.

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429. This included adjustments to cost of goods sold in the amount of $12,916,565.00 and $13,816,278.00 for 2011 and 2012, respectively. *Id.*; *see also* IV ER 441–444 for itemized list of denied deductions.

[14] On May 23, 2013, Docket No. 29212-11, related to 2007 and 2008, was consolidated for trial, briefing, and opinion with Docket No. 30851-12,

After the consolidation, the case was tried in the Tax Court before Judge Holmes in June 2016. *See* II ER 87–88. On November 29, 2018 the court issued its first decision in this case. I ER 14. In that decision, the court held that (1) § 280E of the Internal Revenue Code does not violate the Sixteenth Amendment of the Constitution, and (2) Harborside must calculate its costs of goods sold as a reseller according to Treas. Reg. § 1.471-3(b). I ER 61, 75.

Soon thereafter, on December 20, 2018, the court issued its second decision in this case, in which it found Harborside was not subject to accuracy-related penalties under I.R.C. § 6662. I ER 7, 13.

The Tax Court then ordered the parties to conduct Rule 155 computations in accordance with these decisions. II ER 83–86. On October 11, 2019, the parties submitted their Rule 155 computations. II ER 77–82. After receiving all of the Rule 155 computations, the Tax Court entered final judgment in this case. I ER 1–6. The Tax Court ultimately found Harborside liable for a total of $11,013,236.75 (the

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related to 2009 and 2010. IV ER 445. On April 07, 2015, Docket Nos. 2912-11 and 30851-12, related to 2007 and 2008 and 2009 and 2010, respectively, were consolidated for trial, briefing, and opinion with Docket No. 14776-14. IV ER 417–420.

sum of $545,328.00 for 2007, $1,439,149.00 for 2008, $2,090,080.00 for 2009, $2,551,434.75 for 2010, $2,948,096.00 for 2011, and $1,439,149.00 for 2012). *Id.* It is from these decisions that Harborside appeals to this court, having timely filed a notice of appeal on December 2, 2019. II ER 76.

SUMMARY OF THE ARGUMENT

The application of § 280E to Harborside results in a tax liability that is inconsistent with the U.S. Constitution. The Sixteenth Amendment only permits Congress to levy non-apportioned taxes on "income," and income is defined as gain from labor and capital. *See Eisner v. Macomber*, 252 U.S. 189, 207. However, taxpayers subject to § 280E can be forced to pay tax even in the absence of gain. Harborside is forced to pay taxes in years when it is losing money.

While Congress certainly has the power to limit deductions in various ways, § 280E exceeds such power as it disallows *all* deductions. As a result, the only allowed reduction to income is from the costs of goods sold. Since the deductions for rent, labor, and utilities (for example) are disallowed, § 280E fabricates gain where there was none and imposes a tax based on artificial income. Therefore, § 280E should not be applied to Harborside, as it unconstitutionally results in the taxation of amounts that are not "income" under the Sixteenth Amendment.

The Tax Court erred in holding that Harborside incorrectly calculated its cost of goods sold for years 2007–2012. The issue in this case is an inventory tax accounting issue—whether Harborside correctly calculated its cost of goods sold. There are only two requirements under the tax law for any accounting method, including cost of goods sold: 1) that proper accounting practices be followed; and 2) that the accounting method clearly reflects income.

Internal Revenue Code § 280E, which denies deductions and credits related to trafficking in controlled substances, does not affect Harborside's cost of goods sold calculation. For taxpayers subject to § 280E, such as Harborside, an item of expense either is allocated to cost of goods sold or it is allocated as a deductible expense that is denied by § 280E. In other words, § 280E only works to deny deductions "below-the-line," while cost of goods sold, calculated "above-the-line," is unaffected by § 280E. By claiming that part of Harborside's cost of goods sold should be treated instead as ordinary deductions, those of

Harborside's expenses that are allocated to cost of goods sold are moved below the line and thus disallowed.

There are many cases in which courts have allowed taxpayers to allocate such expenses to cost of goods sold, rather than to deductible business expenses, especially when, like Harborside, a taxpayer used proper accounting methods. *See, e.g., Comm'r v. Idaho Power,* 418 U.S. 1 (1974); *Max Sobel Wholesale Liquors v. Comm'r*, 630 F.2d 670 (9th Cir. 1980).

Harborside's allocation of certain expenses to cost of goods sold, instead of to deductible business expenses, is also permitted by other parts of the tax law. Treas. Reg. § 1.162-1(a) makes clear that there is a category of expenses that can be allocated to either deductible business expenses or to cost of goods sold. Again, Harborside's accounting methods were "best accounting practice" and therefore its allocations to cost of goods sold should be allowed, just as similar allocations were allowed by this Court in *Max Sobel* and by other courts in myriad cases.

There is no suggestion anywhere in the record of this case that Harborside's cost of goods sold accounting either is an improper method of accounting or fails to clearly reflect income—not in the notices of deficiency, not in the Commissioner's briefs in the trial, and not in the Tax Court's opinion. The significance of that absence cannot be overstated—this is a dispute about the federal income tax, after all, and the reality that there is nothing that Harborside has done that unfairly deprives the Treasury of revenue makes this case remarkable.

It should also be noted that there is no dispute of fact in this case—the stipulated facts provide that "the total claimed direct cost of goods sold for Harborside's [2007–2012 returns] are properly reflected on Harborside's [2007–2012] returns," that "these amounts are substantiated and that they were paid or incurred in acquiring inventory." III ER 233–34. "The parties disagree as to the proper characterization of these costs as inventory costs, deductible business expenses, or non-deductible business expenses." III ER 234–235.

STANDARD OF REVIEW

(1) The Ninth Circuit "review[s] the tax court's legal conclusions, including its interpretation of the Internal Revenue Code and Treasury Regulations, de novo." *Estate of Saunders v. Comm'r*, 745 F.3d 953, 957 (9th Cir. 2014) (citing *Metro Leasing & Dev. Corp. v. Comm'r*, 376 F.3d 1015, 1021 (9th Cir.2004)).

(2) The Ninth Circuit "analyze[s] the constitutionality of a statute de novo." *Acosta v. City of Costa Mesa*, 718 F.3d 800, 810 (9th Cir. 2013) (citing *Planned Parenthood of S. Ariz. v. Lawall*, 307 F.3d 783, 786 (9th Cir.2002)).

ARGUMENT

I. § 280E violates the Sixteenth Amendment

A. Summary

In this case, the government is demanding tax payments from Harborside on income it didn't make, and that's a violation of the Sixteenth Amendment to the Constitution. That amendment authorizes only "taxes on incomes, from whatever source derived...."

In 2007 Harborside's taxable income was a loss of $26,407, and yet the Commissioner is claiming Harborside owes $628,516 in tax. That's not because Harborside incorrectly calculated its ordinary expenses—the Commissioner concedes that all the expenses on the return were appropriate and verified but for the application of § 280E. Rather, the Commissioner under § 280E has disallowed Harborside's deductions for salaries, rent, licenses, interest and all the other normal costs of operating a retail establishment, so after those disallowances

Harborside suddenly had taxable income of $2,077,740 instead of a loss of $26,407.

Harborside didn't have any "income" in the conventional meaning of the word, and the conventional meaning is the one used when the Sixteenth Amendment was ratified and subsequent court decisions interpreting "income." § 280E is unique in the entire Internal Revenue Code in that it disallows ALL ordinary deductions and expenses, and its unparalleled scope necessarily results in taxpayers not paying tax on their incomes in clear violation of the Sixteenth Amendment. If more than Harborside's income is being taxed, then it's not an income tax and it's unconstitutional.

B. The Sixteenth Amendment only allows taxes on income

1. Introduction

Harborside is being subjected to an unconstitutional tax because § 280E results in a "direct tax" that's not "apportioned." A brief explanation of how those words are used in the Constitution is therefore necessary.

2. Text of the Sixteenth Amendment

The Sixteenth Amendment to the Constitution, passed by Congress in 1909 and ratified in 1913 (by 42 states): "The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI.

3. Congress has the power to levy two kinds of taxes—direct and indirect

a. Congress has the general power to tax

Congress' basic taxing authority is found in Article I, § 8, Clause 1 of the U.S. Constitution: "The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States."

b. There are two different kinds of taxes—direct taxes and indirect taxes

Indirect taxes include duties, imposts and excises—taxes paid on the possession or sale of property when bought. Indirect taxes are limited by the Uniformity Clause (quoted above).

The second type of federal tax permitted in the Constitution is direct taxes, and they are subject to a different limitation—apportionment. Apportionment is imposed on direct taxes in two different places in the Constitution:

Article I, § 9, Clause 4:

> No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken.

Article I, § 2, Clause 3:

> Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons.

Apportionment means that each State is liable for the tax in proportion to its share of the United States population:

> Imagine state X with twice the population of state Y. For any tax subject to apportionment, X's aggregate liability must be twice Y's. Supposed an income tax has to be apportioned (something that's no longer the case because of the Sixteenth Amendment). If the per capita income in the two states is equal, the same rates could apply in both, and, as required, X's total collection would double Y's. But now suppose X's per capita income is only one-half Y's. *The rates in state X would have to be twice those in state Y to satisfy the apportionment requirement.*

Erik M. Jensen, *The Taxing Power, the Sixteenth Amendment, and the Meaning of "Incomes",* 33 Ariz. St. L.J. 1057, 1067 (2001) (emphasis in original).

The Framers were concerned about this sweeping power to tax, and so they made it politically and administratively difficult to impose a direct tax. Direct taxes would be used to raise revenue only in exceptional circumstances like a war. Jensen, *supra*, at 1077–8.

4. *Hylton v. United States*

The definition of direct tax was first taken up by the Supreme Court in 1796 in *Hylton v. United States*, 3 U.S. 171 (1796). The Court considered the question whether a tax on carriages was a direct tax and thus subject to apportionment. The three opinions in *Hylton* all agree that it was not. Justice Chase wrote "that the direct taxes contemplated by the Constitution, are only two, to wit, a capitation, or poll tax, simply, without regard to property, profession, or any other circumstance, and a tax on LAND." *Id*. at 175.

The opinions all agree that the meaning of "direct taxes" as used in the Constitution was a bit murky. Bruce Ackerman, *Taxation and the Constitution,* 99 Colum. L. Rev. 1, 20-25 (1999); *see also* Calvin H.

Johnson, *Apportionment of Direct Taxes: The Foul-up in the Core of the Constitution*, 7 Wm. & Mary Bill Rts. J. 1 (1998).

It is worth noting that all four justices were involved in the creation of the Constitution—three of them participated in the Constitutional Convention and the fourth was a leader in the Constitution's ratification in North Carolina. Ackerman, *supra*, at 21.[15] It therefore seems reasonable that their interpretation of direct tax would be treated with deference, and *Hylton*'s narrow definition of direct tax prevailed for nearly a century.

5. *Pollock* and the passage of the Sixteenth Amendment

Pollock v. Farmers' Loan and Trust Co., 158 U.S. 601 (1895), concerned the constitutionality of the Wilson Tariff Act of 1894 which provided for a tax of 2% on the amount above $4,000 on the "gains, profits, and income received in the preceding calendar year by every citizen of the United States . . . ." 158 U.S. 601, 639 (1895).[16] In a 5-4

[15] The lawyer for the United States was the former Secretary of the Treasury, Alexander Hamilton.

[16] A previous decision, *Pollock v. Farmers' Loan and Trust, Co.*, 157 U.S. 429 (1895), concerned taxes on income from real estate and bonds, but

decision, the Supreme Court held that the Wilson income tax was a direct tax and it was unconstitutional because it was not apportioned. *Id*. at 634.

The importance of *Pollock* is that for the first time, a tax was struck down on the grounds that it was an unapportioned direct tax. Jensen, *supra*, at 1070–72.

The public outcry over *Pollock* eventually resulted in the passage of the Sixteenth Amendment. Jensen, *supra*, at 1107–23. Affirming the desire of the progressive movement to secure an income tax, President Taft announced his support for a constitutional amendment declaring the income tax to be exempt from challenge as a direct tax. Ackerman, *supra*, at 35.

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public outcry over the first decision lead the Supreme Court to take up the issue of the constitutionality of the general income tax in the second Pollock case. The first *Pollock* was overruled with respect to taxes on bonds by *South Carolina v. Baker*, 485 U.S. 505, 524 (1988).

C. "Income" in the Sixteenth Amendment means gain

1. *Doyle v. Mitchell*

As a result of the passage of the Sixteenth Amendment in 1913, it became possible to have an income tax that was not apportioned. The courts then turned to the question of the definition of income, because only a tax on income would be constitutional.

Doyle v. Mitchell Bros. Co., 247 U.S. 179 (1918) concerned the calculation of income from lumber sales, that is, whether the proceeds of the sale of lumber were to be treated entirely as income or whether "income" requires deductions of expenses from the proceeds of the sale to arrive at the amount to be taxed. The decision explains:

> Whatever difficulty there may be about a precise and scientific definition of "income," it imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities. As was said in *Stratton's Independence v. Howbert*, 231 U.S. 399, 415, 34 Sup. Ct. 136, 58 L. Ed. 285: "Income may be defined as the gain derived from capital, from labor, or from both combined."

Id. at 185.

From the very start, income was gain.

2. *Eisner v. Macomber* recognizes limits on congressional ability to define "income" for purposes of the Sixteenth Amendment

While *Doyle v. Mitchell Bros. Co.* defined "income" for purposes of a federal tax statute, *Eisner v. Macomber*, 252 U.S. 189 (1920), takes the common understanding of "income" and applies it to the Sixteenth Amendment.

Eisner v. Macomber concerned the taxation of a stock dividend where the stockholder held the same percentage ownership of the stock issuing corporation before and after the dividend. The Revenue Act of 1916 provided that stock dividends were to be considered income "to the amount of its cash value[.]" *Id*. at 200 n.1. The taxpayer contended that the statue violated the constitutional provisions "requiring direct taxes to be apportioned according to population, and that the stock dividend was not income within the meaning of the Sixteenth Amendment." *Id*. at 201.

The Supreme Court held for the taxpayer, concluding that the stock dividend was not income and thus could not be taxed under the Sixteenth Amendment, and was not apportioned by population and thus failed the requirements of U.S. Constitution Article I, § 2, Clause 3 and Article 1, § 9, Clause 4. *Id*. at 219.

Eisner v. Macomber is critically important because it shows the Supreme Court's willingness to hold that a specific section of the tax law was not valid on Sixteenth Amendment grounds.

Furthermore, it places the Sixteenth Amendment in constitutional context—the Sixteenth Amendment "did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on income." *Id*. at 206 (citations omitted).

As a result, the Sixteenth Amendment only applies to income taxes:

> A proper regard for its genesis, as well as its very clear language, requires also that this amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts.

Eisner, 252 U.S. at 206.

The Sixteenth Amendment limits Congress:

> [I]t becomes essential to distinguish between what is and what is not "income," as the term is there used, and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives the power to legislate, and within whose limitations alone that power can be lawfully executed.

Id.

Congress is limited to levying taxes on income as it commonly understood: "Income may be defined as the gain derived from capital, from labor, or from both combined . . . ." *Id.* at 207 (citations omitted).

Eisner v. Macomber stands for the common sense proposition that Congress is limited under the Sixteenth Amendment to levying non-apportioned taxes only on income, and that income is defined as gain from labor and capital.

D. The Tax Court's Sixteenth Amendment analysis is wrong

1. Summary of Tax Court analysis

The Tax Court's opinion below upholds the constitutionality of § 280E in four steps:

a. The Sixteenth Amendment limits tax to gross income

"The Constitution does limit Congress to taxing only gross income...." *Patients Mut. Assistance Collective Corp. v. Comm'r*, 151 T.C. 176, 151 T.C. at 208.

b. Gross income is sales minus cost of goods sold ("COGS")

"[G]ross income...is gross receipts minus the cost of goods sold (COGS)." *Patients Mut. Assistance Collective Corp.*, 151 T.C. at 204.

c. All other business expenses can be denied by Congress

"Deductions are statutory, and Congress can grant or deny them as it chooses...." *Patients Mut. Assistance Collective Corp.*, 151 T.C. at 205.

d. Therefore § 280E which denies all other business expenses is constitutional

Harborside "pays tax only on the amount it realizes on sales, which is what the Constitution requires." *Patients Mut. Assistance Collective Corp.*, 151 T.C. at 209.

Steps a, c and d are entirely incorrect, and the Tax Court's misunderstanding of step b is the subject of the second part of this brief see *infra*, at 51.

2. The Sixteenth Amendment limits tax to a common sense definition of income, not gross income

a. The cases cited by the Tax Court do not support using gross income as the Sixteenth Amendment measure of income

The opinion asserts "[t]he Constitution does limit Congress to taxing only gross income, and courts have consistently held—including in cases Harborside cites—that gross income is gross receipts minus *direct* costs." *Id.* At 208. The three cases that the opinion cites show that the statement is flatly incorrect.

In *Reading v. Commissioner*, the Tax Court held (supporting Harborside's position), that "some kind of 'gain' must be realized for there to be income" for purposes of the Sixteenth Amendment but that an individual taxpayer could not deduct the cost of his labor in arriving at gross income. 70 T.C. 730, 733 (1978), *aff'd* 614 F.2d 159 (8th Cir. 1980).

In *Pittsburgh Milk v. Commissioner*, 26 TC 707 (1956), the Tax Court held that the Sixteenth Amendment definition of income looks to realized amounts and that income from milk sold below legal price limits should be calculated based on amounts actually received, and is not relevant to the idea that income for Sixteenth Amendment purposes is gross income.

In *Hofferbert v. Anderson Oldsmobile*, 197 F.2d 504 (4th Cir. 1952), the Court specifically declined to decide the cost on Sixteenth Amendment grounds, holding instead that "Congress intended to tax as income ...only the difference between the sales price and the actual cost of goods sold, even though a part of this cost was paid unlawfully...." *Id.* at 506. In fact, the District Court decision supports Harborside, observing that "[c]onstitutionally the only thing that can be taxed by Congress is 'income.' And the tax actually imposed by Congress has been on net income as distinct from gross income." *Anderson Oldsmobile v. Hofferbert*, 102 F.Supp. 902 (D. Md. 1952).

None of these cases relate to the idea that the Sixteenth Amendment idea of income is identical to the Internal Revenue Code's definition of gross income. This is the missing link in the opinion—because income as used in the Sixteenth Amendment is the conventional idea of income, and not gross income as that term is used in the Internal Revenue Code, these cases discussing gross income are irrelevant.

b. ***The Eisner v. Macomber* definition of income as gain continues to be valid**

It is well-established that other necessary expenses in addition to costs of goods sold must be subtracted from gross receipts to arrive at an amount of income that is subject to taxation under the Sixteenth Amendment.

In *Davis v. United States*, the Court of Appeals for the Second Circuit upheld the constitutionality of allowing deductions for short-term capital losses only to the extent of short-term capital gains. 87 F.2d 323 (2d Cir. 1937). With respect to the relevant section of the Revenue Act of 1932, the taxpayer argued: "(1) that its effect is to cause a direct tax to be levied without apportionment contrary to article 1, § 9 of the Constitution; and (2) that the classification resulting is so unreasonable, arbitrary, and capricious as to violate the due process clause of the Fifth Amendment." *Id*. at 324.

The opinion provides a comprehensive description of the calculation of income for purposes of the Sixteenth Amendment:

> It will be well to note at the start that our scheme of income taxation provides for a method of computation whereby all receipts during the taxable period which are defined as gross income are gathered together and from the total are taken **certain necessary items like cost of property sold; ordinary and necessary expenses incurred in getting the so-called gross income;** depreciation, depletion, and the like in order to reduce the amount computed as gross income **to what is in fact income under the rule of *Eisner v. Macomber***, 252 U.S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A.L.R. 1570, and so lawfully taxable as such. In this way true income is ascertained by **taking from gross income as defined that which is necessary as a matter of actual fact in order to determine what as a matter of law may be taxed as income.** While such subtractions

> are called deductions, as indeed they are, they are not to be confused with deductions of another sort like personal exemptions; deductions for taxes paid; losses sustained in unrelated transactions and other like privileges which Congress has seen fit to accord to income taxpayers under classifications it has established. **While the first kind of deductions are inherently necessary as a matter of computation to arrive at income, the second may be allowed or not in the sound discretion of Congress....Such deductions as distinguished from the first kind are allowed by Congress wholly as a matter of grace.** *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 54 S.Ct. 788, 78 L.Ed. 1348; *Van vleck v. Comm'r*, 80 F.2d 217 (2d Cir. 1935), *Gillette v. Comm'r*, 76 F.2d 6 (2d Cir. 1935).

Id. at 324–25 (emphasis added).

Davis takes *Eisner v. Macomber*'s common sense definition of income and applies it to the different determinants of income—not just cost of goods sold, but other necessary business expenses. The Tax Court decision doesn't mention either *Eisner v. Macomber* or *Davis*, the two cases most directly on point for the Sixteenth Amendment issue in this case. No case contradicts that *Eisner v. Macomber* still stands for the proposition that "income" as used in the Sixteenth Amendment necessarily entails gain.[17]

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[17] *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955) concerns the taxability of exemplary damages for fraud and treble damages awarded

3. Congress does not have the power to deny all deductions

As *Davis* and *Eisner v. Macomber* both point out, it is a violation of the Sixteenth Amendment to deny all deductions—any measure of income must include the idea of gain, and gain can only be measured after necessary expenses for the production of income are taken into account.

The Tax Court decision repeats a common saying about deductions: "Congress can grant or deny them as it chooses—the standard refrain is that they're a matter of Congress's 'legislative grace.'" *Patients Mut. Assistance Collective Corp. v. Comm'r*, 151 T.C. at 205 (citing *INDOPCO, Inc. v. Comm'r*, 503 U.S. 79, 84 (1992), *New Colonial Ice v. Helvering*, 292 U.S. 435, 440 (1934); *Olive v. Comm'r*, 139 T.C. 19, 32 (2012)).

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in private antitrust actions. The Court held that such damages were taxable as gross income under I.R.C. § 61, pointing out that *Eisner v. Macomber* "was not meant to provide a touchstone to all future gross income questions." *Id*. at 477. However, the opinion is referring to broadening the definition of gross income, not the central idea of *Eisner v. Macomber* that income necessarily requires gain. In fact, *Eisner v. Macomber* (as well as *Pollock)* was cited with approval by the Supreme Court as recently as 2012 in *Nat'l F'n Indep. Bus. v. Sebelius*, 567 U.S. 519, 571 (2012).

The phrase “legislative grace” comes from the opinion in *New Colonial Ice v. Helvering*, 292 U.S. 435 (1934) and is cited in the opinion for the idea that Congress can define deductions from gross income in any way that it chooses and that the resulting tax is still an income tax. Not only is that notion incorrect, it is entirely mistaken that *New Colonial Ice* affirms it.

New Colonial Ice concerns an ice making company that ran out of capital before the ice making equipment was fully installed at the factory and the plant was being operated at only 40% of capacity. Creditors’ and stockholders’ committees were formed which discovered that “much stock had been issued of which there was no record and for which no consideration was received.” *Id.* at 438. A new company was organized to take over the assets and liabilities of the old company and continue the business. New stock was issued for new funds, and the new corporation took over from the dissolved old corporation. *Id.*

The tax issue in *New Colonial Ice* was whether the new company was entitled to deduct net operating losses of the old company. The holding is confined to the specific facts:

> [W]e are of opinion that in law and in fact the two corporations were not identical but distinct. This was plainly implied in the transfer of the assets and business from one to the other. That transaction was voluntary and contractual, not by operation of law. Thereafter neither corporation had any control over the other; the old corporation had no interest in the assets or business, and the chance of gain and the risk of loss were wholly with the new one.

Id. at 441–42 (footnote omitted).

New Colonial Ice is an unremarkable case that would long ago have been confined to the dustbin of forgotten tax cases were it not for a truly unfortunate rhetorical flourish sitting in the middle of the opinion:

> What is being taxed in this instance is the income realized by the new company in conducting the business after the transfer; and the sole matter for decision is whether, under § 204(b), there shall be deducted from that income the losses suffered by the old company in its conduct of the same business before the transfer. . . .The power to tax income like that of the new corporation is plain and extends to the gross income. *Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed*. . . . Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.

Id. at 439–40 (emphasis added).

The emphasized sentence is obviously mere dicta. Erwin Griswold, arguably the most important tax lawyer of his generation, wrote a Harvard Law Review article arguing against its use:

> Although the *New Colonial Ice* formula is a "now familiar rule," and is cited by Government lawyers in their briefs as glibly as taxpayers' lawyers once relied on *Gould v. Gould* [tax laws should be construed in favor of the taxpayer], it has never been fully considered by the Court. Taken literally, it would mean that Congress may deny all deductions and impose a tax on gross income. This is a large question, about which there may be reasonable doubts, even today. Could Congress, for example, impose the tax on the entire proceeds from the sale of property without any allowance for the cost of the property? Could it deny deductions for all wages paid?

Erwin N. Griswold, *An Argument Against the Doctrine that Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 Harv. L. Rev. 1142, 44 (1943) (footnote omitted).

New Colonial Ice did not address any currently deductible item of expense but instead addressed one taxpayer's income tax attributes (items of expense that had been rightfully been deducted in previous tax years that were being brought forward to future tax years in the form of net operating loss carryforwards) *and whether such taxpayer could unilaterally transfer such attributes to a separate taxpayer/legal entity.*

It is most regrettable that courts have used this language to disallow current deductions of items of expense to which a taxpayer is rightfully entitled under the Sixteenth Amendment concept of an income tax.

E. An Example and Conclusion

As discussed above, Harborside is being taxed on income it doesn't have, so that tax isn't an income tax.

A more general example clarifies why this is a common result with § 280E. To begin with, it's clear that COGS must be applied to reduce gross receipts:

> [A] congressional attempt to tax the gross receipts of a business engaged in sales should fail. A taxpayer who purchased 100 widgets at a cost of $10 each and sold them at a price of $9 each would have gross receipts or sales of $900, which after being reduced by "the cost of goods sold" ("COGS") of $1,000 . . . would yield a loss of $100. Given that obvious loss, Congress could not tax the gross receipts of $900 as if it were "income".... That is, under the Sixteenth Amendment it is "mandatory" to allow a reduction for COGS, since we do not know whether a taxpayer-seller had any "income" at all until we know whether the price he obtained for the item he sold exceeded the cost he had incurred to produce that item.

N. Cal. Small Bus. Assistants Inc. v. Comm'r, 153 T.C. No. 4, 26–27 (Gustafson, J., dissenting).

But allowing COGS is necessary but not sufficient—the problem with § 280E, however, is that is disallows all deductions, and as a result "the determination of the supposed 'income tax' liability of a taxpayer trafficking in illegal drugs bypasses altogether any inquiry as to his gain." *Id.* at 32. Judge Gustafson's example compels her conclusion:

> This point is illustrated by expanding upon the example of the widget seller. Suppose he purchased 100 widgets at a cost of $6 per widget (instead of $10 as above), yielding COGS of $600, and suppose that for his business he leased a retail space for $200 and paid wages of $200 to employees, yielding additional expenses of $400, so that his out-of-pockets expenditures for COGS ($600) and additional expenses ($400) totaled $1,000. If he then sold the 100 widgets at a price of $9 each, he would have gross receipts of $900, which would, after being reduced by his total costs of $1,000 (the sum of COGS and total expenses), yield a loss of $100. No one would propose that this seller had any gain. And if his product had not been widgets costing $600 but illegal drugs costing the same amount, he would have the same negative outcome—a loss of $100. But despite this obvious loss, § 280E would disallow any deduction for his rent and wage expenses totaling $400, yielding a supposed taxable "income" of $300—despite his having incurred not gain but loss. § 280E would fabricate gain where there was none and would impose a tax based on artificial income.
>
> I would hold that this wholesale disallowance of all deductions transforms the ostensible income tax into something that is not an income tax at all, but rather a tax on an amount greater than a taxpayer's "income" within the meaning of the Sixteenth Amendment. Accordingly, I would hold that the Sixteenth Amendment does not permit

> Congress to impose such a tax and that § 280E is therefore unconstitutional.

Id. at 33.

The truth is that you can count as many different things as income as you please, but there still has to be gain. No case contradicts that. *Eisner v. Macomber* still stands for the proposition that "income" as used in the Sixteenth Amendment necessarily entails gain. As shown in the example from *Northern California Small Business Assistants* above at 41-43, taxpayers subject to § 280E can be forced to pay tax even in the absence of gain—just as Harborside was.

Of course Congress has the power to limit deductions in various ways, but that is not what § 280E does—it disallows all deductions. Before the enactment of § 280E in 1982 there has never been such a sweeping disallowance of deductions, and § 280E continues to be unique in the Internal Revenue Code in its breadth.

Harborside's tax liability on fictitious income and the clear reality that tax in the absence of gain flows directly from the disallowance of all deductions leads to the inescapable conclusion that § 280E violates the Sixteenth Amendment. Harborside is respectfully requesting that § 280E be invalidated accordingly as unconstitutional.

II. Harborside correctly calculated its cost of goods sold

A. Background

1. Origins of § 280E

A 1981 Tax Court decision held that a taxpayer engaged in selling illegal drugs was allowed to deduct his business expenses because they "were made in connection with [the taxpayer's] trade or business and were both ordinary and necessary." *Edmonson v. Comm'r*, 42 T.C.M. 1533 (1981). Citing public policy against drug dealing, Congress enacted Internal Revenue Code § 280E in 1982:

> No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

I.R.C. § 280E (2018).

The Senate Finance Committee report explained:

> All deductions and credits for amounts paid or incurred in the illegal trafficking in drugs listed in the Controlled Substances Act are disallowed. To preclude possible

> challenges on constitutional grounds, the adjustment to gross receipts with respect to effective costs of goods sold is not affected by this provision of the bill.[18]

S. Rep. No. 97-494, at 309 (1982).

2. Definition of COGS

COGS isn't defined in the Internal Revenue Code or any Treasury Regulation but is referred to in several places. Treas. Reg. § 1.61-3(a) provides that COGS must be subtracted from total sales in order to arrive at gross income, and states "[t]he cost of goods sold should be determined in accordance with the method of accounting consistently used by the taxpayer."

Treas. Reg. § 1.162-1(a) gives the general rule—"[t]he cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income." The regulation points out that if an item of expense may be categorized as either COGS or a deductible business expense, it must go into COGS:

[18] This is the entire "Explanation of Provision." There is no further discussion of the constitutional issue or why preserving the cost of goods sold calculation is necessary or sufficient to insulate against possible constitutional defect. *See* S. Rep. No. 97-494, at 309 (1982). The Senate Bill was adopted in conference. H.R. Rep. No. 97-760, at 598 (1982) (Conf. Rep.).

"No such item shall be included in business expenses, however, to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in determining the gain or loss basis of its plant, equipment, or other property." *Id.*

The Regulations explicitly contemplate a category of expenses that can be allocated to either deductible business expenses or to COGS, and if the expense can be allocated to COGS under the taxpayer's accounting methods, it **must** be allocated to COGS.

3. COGS is Determined before Deductions

The leading case on the tax treatment of cost of goods sold is *Max Sobel Wholesale Liquors v. Commissioner*, 630 F.2d. 670 (9th Cir. 1980). The taxpayer, Max Sobel Wholesale Liquors, "secretly transferred, as an added consideration for sales, extra liquor to some of its customers in fiscal 1973 and 1974 in violation of California law providing for minimum prices." *Id.* at 671. The Commissioner "disallowed the inclusion of the value of the extra liquor in taxpayer's [COGS,]" asserting that such amount was instead a deduction and thus disallowed under I.R.C. § 162(c)(2) barring the deduction of illegal payments. *Id.*

This Court disagreed:

> For good or ill, tax law distinguishes between exclusions from gross income ("above the line" items) and deductions from gross income ("below the line" items). See generally *B.C. Cook & Sons v. Comm'r*, 65 T.C. 422 (1975), aff'd, 584 F.2d 53 (5th Cir. 1978). "Gross income," I.R.C. § 61, is determined by subtracting all "above the line" items from gross receipts. See Treas. Reg. § 1.61-3(a). The very definition of "gross income" has been thought to mandate the exclusion of certain amounts (e.g., the cost of goods sold) from that figure, even in the absence of specific statutory authority for such exclusion.

Id. at 671.

The Court concludes about the illegal payment:

> Rather than directly reducing gross receipts, taxpayer's price-adjustment method results in a decrease in the value of closing inventory, which is accounted for as an increase in the cost of goods sold, which in turn is subtracted "above the line" from gross receipts to determine gross income. See *Thor Power Tool v. Comm'r*, 439 U.S. 522, 530 n.9 (1979). Only after this computation will tax accounting consider potential deductions, if any, from gross income. Therefore if § 162(c)(2) operates only to disallow potential deductions, it is inapplicable to the present case.

Id. at 672.

Max Sobel makes clear that determination of COGS comes first—limitations on deductions come second.

4. Both the Tax Court and the Commissioner Misunderstand COGS

Max Sobel—clearly the controlling precedent in this Court on the priority of determining COGS before deductions—is absent from the Tax Court opinion and the Commissioner's arguments.[19]

The Commissioner's position is that first a taxpayer computes its deductions and then determines which expenses are deferred under COGS. Gov't brief at 77. "[T]he Court's conclusion on the extent of § 280E's application to petitioner's business will inform its holding on the proper method for computing its inventory." Gov't brief at fn. 321. Under *Max Sobel*, this is exactly backwards—determine COGS first, then determine the deductibility of other expenses.

Similarly, the Tax Court opinion claims that "[t]he big difference between deductions and COGS adjustments is timing." *Patients Mut. Assistance Collective Corp.*, 151 T.C. at 205. This misses the significance of the difference between an exclusion from gross income and a deduction from gross income.

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[19] *Max Sobel* is cited by Harborside's counsel in arguing for taxpayer's COGS accounting methods. Petitioner's Seriatim Reply Brief at 17, II ER 89.

B. Harborside correctly determined COGS

1. Statutory requirements for tax accounting

I.R.C. § 446 provides the general rule for methods of accounting in I.R.C. § 446(a): "Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books."

There is an important limit to the general rule, however—the clear reflection of income requirement: "If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income." I.R.C. § 446(b)

I.R.C. § 471(a) restates the rule specifically for inventories:

> Whenever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

I.R.C. § 471(a).[20]

These two tests are clear and they have been applied specifically in the context of inventory tax issues for over a century.[21]

2. Harborside's COGS practices followed the established rules

a. GAAP creates presumption that best accounting practice is followed

Tax accounting starts with financial statement accounting, as I.R.C. § 446 and I.R.C. § 471 make clear. Treas. Reg. § 1.446-1(a)(2) elaborates:

> It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent

[20] The rule is restated in Treas. Reg. § 1.471-2(a): "§ 471 provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) It must clearly reflect the income."
[21] I.R.C § 471(a)(2018) is basically unchanged from 1918: "That whenever, in the opinion of the Commissioner, the use of inventories is necessary in order to clearly determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income." Revenue Act of 1918, ch. 18, § 203, 40 Stat. 1060 (1919).

> application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

Treas. Reg. § 1.446-1(a)(2).

As the Supreme Court pointed out in *Thor Power Tool v. Commissioner*, 439 U.S. 522, 532 (1979), "best accounting practice" is "a phrase that is synonymous with 'generally accepted accounting principles.'"[22]

b. GAAP rules for determining COGS

GAAP refers to the set of rules, standards and practices of the Financial Accounting Standards Board ("FASB"). The FASB Accounting Standards Codification ("ASC") is organized as a series of topics. *See* Financial Accounting Standards Board, *Accounting Standards Codification*, https://asc.fasb.org (last visited March 17, 2020).

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[22] The discussion in *Thor Power* of the primacy of the second test (the clear reflection of income requirement) over the first test (the best accounting practice requirement), *id*. at 540, is not relevant to this case because there is no contention by the Commissioner that Harborside's accounting methods did not clearly reflect income.

ASC Topic 330-3-1, Inventory:

> The primary basis of accounting for inventories is cost, which has been defined generally as the price paid or consideration given to acquire an asset. As applied to inventories, cost means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location. It is understood to mean acquisition and production cost, and its determination involves many considerations.

(Fin. Accounting Standards Bd. 2009).

The definition of an inventory's cost as "the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location[,]" *id.*, does not suggest a uniform definition of inventory as each business using GAAP operates in its own industry and uses its own business model.

c. How Harborside determined COGS

Harborside followed GAAP by allocating to COGS the costs of acquiring the cannabis and preparing it for sale. There was extensive testimony at the Tax Court trial regarding the duties of the employees and allocation of floor space at the dispensary. II ER 182–218. On the basis of this testimony, floor plan exhibits, and Harborside's tax returns, trial counsel produced three appendices to his seriatim opening brief—Appendix A: Employee Wage Allocations, Appendix B: Floor Space Allocations, and Appendix C: Yearly Cost Allocation Tables. II ER 102–106, 107–111, 112–133. In addition to the "Other Items Claimed in Cost of Goods Sold" in Table I, Harborside claimed additional amounts allocable to COGS under appropriate accounting methods at trial.

d. Taxpayers comparable to Harborside determined COGS similarly

Even though Harborside is a retail store, it's not comparable to a book store where cartons of books come in the back, are unloaded, and then put on display in the front of the store. It more closely resembles a grocery store where food items come in the back of the store and are then prepared for sale. For example, a side of beef arrives at the loading dock of a grocery store. The butcher breaks down the side of beef into various cuts and then other personnel package and label the cuts, after which they are put on display in the front of the store. As described above *infra*, at 14-17, the cannabis arrives at the back of the dispensary and then there is extensive testing and preparation before it is put on display in the front.

Here's how some large grocery store chains include food preparation costs in COGS:

> The "Merchandise costs" line item of the Consolidated Statements of Operations includes product costs, net of discounts and allowances; advertising costs (see separate discussion below); inbound freight charges; warehousing costs, including receiving and inspection costs; transportation costs; and food production and operational costs. . . . The Company's approach is to include in the "Merchandise costs" line item the direct, net costs of acquiring products and making them available to customers in its stores.

The Kroger Co., Annual Report (Form 10-K) 49–50 (Apr. 3, 2018).

> Cost of goods sold includes cost of inventory sold during the period (net of discounts and allowances), distribution and food preparation costs, and shipping and handling costs.

Whole Foods Market, Inc., Annual Report (Form 10-K) (Nov. 22, 2013).

C. The Tax Court misunderstands COGS

1. Tax Court decision

The Tax Court decision doesn't begin with the correct premise, namely that COGS must be determined first, then remaining expenses classified as different types of deduction as appropriate. By ignoring *Max Sobel*, the opinion goes astray.

But the error is compounded—Judge Holmes ignores the statutory framework of the two tests (clear since 1918) for a taxpayer's method of accounting, including for inventory: "(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) It must clearly reflect the income." Treas. Reg. § 1.471-2(a).

Judge Holmes disregards his findings of fact regarding Harborside's elaborate systems of cannabis procurement, inspection, processing and storage, preferring a procrustean approach—the opinion flatly declares that Harborside is "a reseller for purposes of § 471 and must adjust for its COGS according to Treas. Reg. § 1.471-3(b). *Patients Mut. Assistance Collective Corp.*, 151 T.C. at 213; I ER 75. As a result, Harborside can only include in COGS "its inventory price and transportation costs." *Patients Mut. Assistance Collective Corp.*, 151 T.C. at 210; I ER 70.

2. The Tax Court improperly changed Harborside's accounting methods

a. Harborside's accounting methods, including COGS calculations, were not challenged as improper

There is no suggestion anywhere in the record of this case that Harborside's accounting methods were inappropriate. The opinion observes, "[k]eeping good books and records was one of Harborside's strengths, and the Commissioner agreed in pretrial stipulations in each of these cases that Harborside substantiated all its claimed deductions and COGS for all of the tax years at issue and that all of them were paid or incurred in a trade or business." *Patients Mut. Assistance Collective Corp. v. Comm'r*, 116 T.C.M. 570 at 6 (T.C. 2018); I ER 12.

The Commissioner doesn't understand the first requirement of "best accounting practice in the trade of business," contending:

> Petitioner cites to Generally Accepted Accounting Principles but does not show how financial accounting conventions amend the Internal Revenue Code. It provides no authority for its proposal to revamp the tax accounting of inventories by leaving to taxpayers decisions about whether an item is an expenses [sic] or an inventory cost.

I ER 98.

b. Harborside's accounting methods, including its COGS calculations, were not challenged as failing to clearly reflect income

There is no suggestion by the Tax Court or the Commissioner that Harborside's accounting methods failed to clearly reflect income.

There couldn't be a failure to clearly reflect income no matter how Harborside chooses to determine COGS—Harborside's inventory turns over constantly, so it doesn't matter whether an expense is allocated above or below the line from the perspective of matching income and expenses. If inventory turns over constantly, whether an expense is deducted now or allocated to COGS and reduces taxable income later when the item is sold is irrelevant.

3. The Tax Court improperly applied Treas. Reg. 1.471-3

a. There are other choices to reflect circumstances

The Tax Court summarily asserts Harborside must use Treas. Reg. 1.471-3(b). But obviously "inventory rules cannot be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business." Treas. Reg. § 1.471-2(b).

COGS necessarily varies—Treas. Reg. § 1.471-3(d) provides that "[i]n any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry." There is no reasoning given why Treas. Reg. 1-471-3(b) should apply and not Treas. Reg. 1.471-3(d).

b. It is wrong to apply Treas. Reg. 1.471-3(b) where the taxpayer is not a simple reseller

It's not apparent why Treas. Reg. § 1.471-3(b) is the correct regulation to apply to Harborside. Applying Treas. Reg. § 1.471-3(b) to the department store Montgomery Ward, the Tax Court noted that "[w]ith a few possible exceptions, Ward acquired its merchandise as finished goods in saleable condition, and sells its merchandise with or without installation or merchandise preparation charges." *Marcor, Inc. v. Comm'r*, 89 T.C. 181, 190 (1987) (footnote omitted). That is certainly not Harborside's circumstance.

The Commissioner's post-trial brief does not contend that the Treas. Reg. § 1.471-3(b) reseller regulations apply to Harborside—instead, the brief just mentions that there are several sets of inventory regulations under § 471 that could possibly apply, but never states which regulations should apply to Harborside. II ER 93.

Further, even if Treas. Reg. § 1.471-3(b) applies to Harborside, the costs it allocated to COGS were in fact for acquiring the merchandise in a condition to sell to customers.

As discussed above *infra*, at 14-17, Harborside had employees acquiring specific strains of cannabis and engaging in cannabis inspection, testing, trimming, manicuring and curing. II ER 140–142, 158, 160–161. Employees had job titles such as Purchasing Manager, Purchasing Assistant Manager, and Purchasing Assistant, spending 100% of their time acquiring inventory. II ER 102–103, 185–186. Other employees had job titles such as Inventory Managers and Inventory Associates, spending 100% of their time managing inventory, checking weights, moving inventory, and storing it. II ER 103. Still other employees had the job title Processing Associate—they spent 100% of their time devoted to making "raw" cannabis ready for resale, including further trimming, weighing, packaging and stickering. II ER 103–104.

All of the above expenses should be allocated to COGS, but are barred from being included in inventory costs by the Tax Court's interpretation of the Treas. Reg. § 1.471-3(b) regulations. Another way of looking at the issue is to pose the question—is Kroger a reseller or not? Does Treas. Reg. § 1.471-3(b) apply to it or not? It doesn't really matter, because Kroger calculates its cost of goods sold using "costs of acquiring products and making them available to customers in stores." The Kroger Co., Annual Report (Form 10-K) 50 (Apr. 3, 2018).

Kroger's COGS calculations are entirely appropriate for its business—this is why the Commissioner doesn't challenge Kroger or Whole Foods or any other similar business, and he should leave Harborside alone, too.

4. In case of conflict between using proper COGS methods and applying Treas. Reg. 1.471-3, COGS methods prevail

This Court takes an expansive view of the items appropriately allocated to cost of goods sold. The Tax Court's opinion in *Max Sobel* discussed the issue of allocating to cost of goods sold an item of expense that could be disallowed as a deduction due to illegality:

> Depending on the nature of the business, the cost of goods sold may include material, labor and overhead. There may be certain expenses of a dual character which may be chargeable either to overhead in the cost of goods sold or deducted as an administrative or sales expenses. A typical example would be a bribe given for the purpose of obtaining goods or for the purpose of expediting its delivery to the taxpayer for manufacture and resale.

Max Sobel at 485.

In discussing this possibility, this Court pointed out that "[w]e doubt the existence of such a category (see the final sentence of Treas. Reg. § 1.471-3(b), but in any event hold that if the regulations purport to extent to the items in the present case, they are invalid to that extent." *Max Sobel Wholesale Liquors v. Comm'r*, 630 F.2. 670, 673 (9th Cir. 1980).

The fundamental nature of the exclusion from income of cost of goods sold means that Harborside should be permitted to use appropriate methods to calculate COGS.[23]

[23] In I.R.S. Chief Counsel Memorandum 201504011, the Commissioner advances the theory that "[a] taxpayer trafficking in a Schedule I or Schedule II controlled substance determines COGS using the applicable inventory-costing regulations under I.R.C. § 471 as they existed when enacted." I.R.S. Chief Counsel Memorandum 201504011 from Matthew A. Houtsma, Associate Area Counsel to W. Thomas McElroy, Jr. (Jan. 23, 2015), https://www.irs.gov/pub/irs-wd/201504011.pdf. As one commentator pointed out, "explicitly requiring the use of regulations in effect in 1982, CCA 201504011 requires that individuals in the marijuana industry must be knowledgeable regarding tax laws from more than thirty years ago as they appeared in the 1954 version of the Code." Debra Sanders and Susan Gill, *Guidance on Inventory Methods for Medical and Recreational Marijuana Businesses*, 122 J. Tax'n 218, 220 (2015). Even if this peculiar theory is valid, it does not affect Harborside's determination of COGS.

5. § 263A Does Not Apply

Much was made in the proceedings below of the potential applicability of I.R.C. § 263A to Harborside's allocations to COGS. § 263A is unimportant to the tax deficiency assessments being appealed, however. There are six tax years at issue here, and in only one—the tax year ended July 31, 2010—did Harborside claim any amount under § 263A. The notice of deficiency disallows Harborside's § 263A deduction for that year in the amount of $55,511. IV ER 431. That's the only § 263A amount at issue here, and taxpayer is willing to concede this disallowance.

D. Conclusion

Harborside respectfully requests that this Court reverse, as Section 280E violates the Sixteenth Amendment and its attendant prohibition on the taxation of income that does not represent gain. Alternatively, this Court should reverse and remand with instructions that the Tax Court determine Harborside's COGS under the approach described in this brief, namely, relying on the taxpayer's accounting methods for allocation of costs to COGS.

Dated: May 26, 2020

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), I certify that:

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 12,255 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

This brief complies with the typeface requirements of Fed R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionately spaced typeface using Microsoft Word 2016, Century Schoolbook 14-point font.

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CERTIFICATE OF SERVICE

I hereby certify that on May 26, 2020, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

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NO. 19-73078

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PATIENTS MUTUAL ASSISTANCE COLLECTIVE CORPORATION D.B.A
HARBORSIDE HEALTH CENTER,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

On Appeal from the United States Tax Court
Nos.: 2912-11; 30851-12; 14766-14
Hon. Mark V. Holmes

ADDENDUM TO OPENING BRIEF FOR APPELLANT

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ADDENDUM TABLE OF CONTENTS

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Federal Rules of Appellate Procedure (Refs & Annos)
Title VII. General Provisions

Federal Rules of Appellate Procedure Rule 26.1, 28 U.S.C.A.

Rule 26.1 Disclosure Statement

Currentness

(a) Nongovernmental Corporations. Any nongovernmental corporation that is a party to a proceeding in a court of appeals must file a statement that identifies any parent corporation and any publicly held corporation that owns 10% or more of its stock or states that there is no such corporation. The same requirement applies to a nongovernmental corporation that seeks to intervene.

(b) Organizational Victims in Criminal Cases. In a criminal case, unless the government shows good cause, it must file a statement that identifies any organizational victim of the alleged criminal activity. If the organizational victim is a corporation, the statement must also disclose the information required by Rule 26.1(a) to the extent it can be obtained through due diligence.

(c) Bankruptcy Cases. In a bankruptcy case, the debtor, the trustee, or, if neither is a party, the appellant must file a statement that:

(1) identifies each debtor not named in the caption; and

(2) for each debtor that is a corporation, discloses the information required by Rule 26.1(a).

(d) Time for Filing; Supplemental Filing. The Rule 26.1 statement must:

(1) be filed with the principal brief or upon filing a motion, response, petition, or answer in the court of appeals, whichever occurs first, unless a local rule requires earlier filing;

(2) be included before the table of contents in the principal brief; and

(3) be supplemented whenever the information required under Rule 26.1 changes.

(e) Number of Copies. If the Rule 26.1 statement is filed before the principal brief, or if a supplemental statement is filed, an original and 3 copies must be filed unless the court requires a different number by local rule or by order in a particular case.

CREDIT(S)

(Added Apr. 25, 1989, eff. Dec. 1, 1989; amended Apr. 30, 1991, eff. Dec. 1, 1991; Apr. 29, 1994, eff. Dec. 1, 1994; Apr. 24, 1998, eff. Dec. 1, 1998; Apr. 29, 2002, eff. Dec. 1, 2002; Apr. 25, 2019, eff. Dec. 1, 2019.)

F. R. A. P. Rule 26.1, 28 U.S.C.A., FRAP Rule 26.1
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United States Code Annotated
Federal Rules of Appellate Procedure (Refs & Annos)
Title VII. General Provisions

Federal Rules of Appellate Procedure Rule 28, 28 U.S.C.A.

Rule 28. Briefs

Currentness

(a) Appellant's Brief. The appellant's brief must contain, under appropriate headings and in the order indicated:

(1) a disclosure statement if required by Rule 26.1;

(2) a table of contents, with page references;

(3) a table of authorities--cases (alphabetically arranged), statutes, and other authorities--with references to the pages of the brief where they are cited;

(4) a jurisdictional statement, including:

(A) the basis for the district court's or agency's subject-matter jurisdiction, with citations to applicable statutory provisions and stating relevant facts establishing jurisdiction;

(B) the basis for the court of appeals' jurisdiction, with citations to applicable statutory provisions and stating relevant facts establishing jurisdiction;

(C) the filing dates establishing the timeliness of the appeal or petition for review; and

(D) an assertion that the appeal is from a final order or judgment that disposes of all parties' claims, or information establishing the court of appeals' jurisdiction on some other basis;

(5) a statement of the issues presented for review;

(6) a concise statement of the case setting out the facts relevant to the issues submitted for review, describing the relevant procedural history, and identifying the rulings presented for review, with appropriate references to the record (see Rule 28(e));

(7) a summary of the argument, which must contain a succinct, clear, and accurate statement of the arguments made in the body of the brief, and which must not merely repeat the argument headings;

(8) the argument, which must contain:

(A) appellant's contentions and the reasons for them, with citations to the authorities and parts of the record on which the appellant relies; and

(B) for each issue, a concise statement of the applicable standard of review (which may appear in the discussion of the issue or under a separate heading placed before the discussion of the issues);

(9) a short conclusion stating the precise relief sought; and

(10) the certificate of compliance, if required by Rule 32(g)(1).

(b) Appellee's Brief. The appellee's brief must conform to the requirements of Rule 28(a)(1)-(8) and (10), except that none of the following need appear unless the appellee is dissatisfied with the appellant's statement:

(1) the jurisdictional statement;

(2) the statement of the issues;

(3) the statement of the case; and

(4) the statement of the standard of review.

(c) Reply Brief. The appellant may file a brief in reply to the appellee's brief. Unless the court permits, no further briefs may be filed. A reply brief must contain a table of contents, with page references, and a table of authorities--cases (alphabetically arranged), statutes, and other authorities--with references to the pages of the reply brief where they are cited.

(d) References to Parties. In briefs and at oral argument, counsel should minimize use of the terms "appellant" and "appellee." To make briefs clear, counsel should use the parties' actual names or the designations used in the lower court or agency proceeding, or such descriptive terms as "the employee," "the injured person," "the taxpayer," "the ship," "the stevedore."

(e) References to the Record. References to the parts of the record contained in the appendix filed with the appellant's brief must be to the pages of the appendix. If the appendix is prepared after the briefs are filed, a party referring to the record must follow one of the methods detailed in Rule 30(c). If the original record is used under Rule 30(f) and is not consecutively paginated, or if the brief refers to an unreproduced part of the record, any reference must be to the page of the original document. For example:

- Answer p. 7;

- Motion for Judgment p. 2;

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• Transcript p. 231.

Only clear abbreviations may be used. A party referring to evidence whose admissibility is in controversy must cite the pages of the appendix or of the transcript at which the evidence was identified, offered, and received or rejected.

(f) Reproduction of Statutes, Rules, Regulations, etc. If the court's determination of the issues presented requires the study of statutes, rules, regulations, etc., the relevant parts must be set out in the brief or in an addendum at the end, or may be supplied to the court in pamphlet form.

(g) [Reserved]

(h) [Reserved]

(i) Briefs in a Case Involving Multiple Appellants or Appellees. In a case involving more than one appellant or appellee, including consolidated cases, any number of appellants or appellees may join in a brief, and any party may adopt by reference a part of another's brief. Parties may also join in reply briefs.

(j) Citation of Supplemental Authorities. If pertinent and significant authorities come to a party's attention after the party's brief has been filed--or after oral argument but before decision--a party may promptly advise the circuit clerk by letter, with a copy to all other parties, setting forth the citations. The letter must state the reasons for the supplemental citations, referring either to the page of the brief or to a point argued orally. The body of the letter must not exceed 350 words. Any response must be made promptly and must be similarly limited.

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(As amended Apr. 30, 1979, eff. Aug. 1, 1979; Mar. 10, 1986, eff. July 1, 1986; Apr. 25, 1989, eff. Dec. 1, 1989; Apr. 30, 1991, eff. Dec. 1, 1991; Apr. 22, 1993, eff. Dec. 1, 1993; Apr. 29, 1994, eff. Dec. 1, 1994; Apr. 24, 1998, eff. Dec. 1, 1998; Apr. 29, 2002, eff. Dec. 1, 2002; Apr. 25, 2005, eff. Dec. 1, 2005; Apr. 16, 2013, eff. Dec. 1, 2013; Apr. 28, 2016, eff. Dec. 1, 2016; Apr. 25, 2019, eff. Dec. 1, 2019.)

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Federal Rules of Appellate Procedure Rule 32, 28 U.S.C.A.

Rule 32. Form of Briefs, Appendices, and Other Papers

Currentness

(a) Form of a Brief.

(1) Reproduction.

(A) A brief may be reproduced by any process that yields a clear black image on light paper. The paper must be opaque and unglazed. Only one side of the paper may be used.

(B) Text must be reproduced with a clarity that equals or exceeds the output of a laser printer.

(C) Photographs, illustrations, and tables may be reproduced by any method that results in a good copy of the original; a glossy finish is acceptable if the original is glossy.

(2) Cover. Except for filings by unrepresented parties, the cover of the appellant's brief must be blue; the appellee's, red; an intervenor's or amicus curiae's, green; any reply brief, gray; and any supplemental brief, tan. The front cover of a brief must contain:

(A) the number of the case centered at the top;

(B) the name of the court;

(C) the title of the case (see Rule 12(a));

(D) the nature of the proceeding (e.g., Appeal, Petition for Review) and the name of the court, agency, or board below;

(E) the title of the brief, identifying the party or parties for whom the brief is filed; and

(F) the name, office address, and telephone number of counsel representing the party for whom the brief is filed.

(3) Binding. The brief must be bound in any manner that is secure, does not obscure the text, and permits the brief to lie reasonably flat when open.

(4) Paper Size, Line Spacing, and Margins. The brief must be on 8 ½ by 11 inch paper. The text must be double-spaced, but quotations more than two lines long may be indented and single-spaced. Headings and footnotes may be single-spaced. Margins must be at least one inch on all four sides. Page numbers may be placed in the margins, but no text may appear there.

(5) Typeface. Either a proportionally spaced or a monospaced face may be used.

(A) A proportionally spaced face must include serifs, but sans-serif type may be used in headings and captions. A proportionally spaced face must be 14-point or larger.

(B) A monospaced face may not contain more than 10 ½ characters per inch.

(6) Type Styles. A brief must be set in a plain, roman style, although italics or boldface may be used for emphasis. Case names must be italicized or underlined.

(7) Length.

(A) Page Limitation. A principal brief may not exceed 30 pages, or a reply brief 15 pages, unless it complies with Rule 32(a)(7)(B).

(B) Type-Volume Limitation.

(i) A principal brief is acceptable if it:

• contains no more than 13,000 words; or

• uses a monospaced face and contains no more than 1,300 lines of text.

(ii) A reply brief is acceptable if it contains no more than half of the type volume specified in Rule 32(a)(7)(B)(i).

(b) Form of an Appendix. An appendix must comply with Rule 32(a)(1), (2), (3), and (4), with the following exceptions:

(1) The cover of a separately bound appendix must be white.

(2) An appendix may include a legible photocopy of any document found in the record or of a printed judicial or agency decision.

(3) When necessary to facilitate inclusion of odd-sized documents such as technical drawings, an appendix may be a size other than 8 ½ by 11 inches, and need not lie reasonably flat when opened.

(c) Form of Other Papers.

(1) Motion. The form of a motion is governed by Rule 27(d).

(2) Other Papers. Any other paper, including a petition for panel rehearing and a petition for hearing or rehearing en banc, and any response to such a petition, must be reproduced in the manner prescribed by Rule 32(a), with the following exceptions:

(A) A cover is not necessary if the caption and signature page of the paper together contain the information required by Rule 32(a)(2). If a cover is used, it must be white.

(B) Rule 32(a)(7) does not apply.

(d) Signature. Every brief, motion, or other paper filed with the court must be signed by the party filing the paper or, if the party is represented, by one of the party's attorneys.

(e) Local Variation. Every court of appeals must accept documents that comply with the form requirements of this rule and the length limits set by these rules. By local rule or order in a particular case, a court of appeals may accept documents that do not meet all the form requirements of this rule or the length limits set by these rules.

(f) Items Excluded from Length. In computing any length limit, headings, footnotes, and quotations count toward the limit but the following items do not:

• cover page;

• disclosure statement;

• table of contents;

• table of citations;

• statement regarding oral argument;

• addendum containing statutes, rules, or regulations;

• certificate of counsel;

• signature block;

• proof of service; and

• any item specifically excluded by these rules or by local rule.

(g) Certificate of Compliance.

(1) Briefs and Papers That Require a Certificate. A brief submitted under Rules 28.1(e)(2), 29(b)(4), or 32(a)(7)(B)--and a paper submitted under Rules 5(c)(1), 21(d)(1), 27(d)(2)(A), 27(d)(2)(C), 35(b)(2)(A), or 40(b)(1)--must include a certificate by the attorney, or an unrepresented party, that the document complies with the type-volume limitation. The person preparing the certificate may rely on the word or line count of the word-processing system used to prepare the document. The certificate must state the number of words--or the number of lines of monospaced type--in the document.

(2) Acceptable Form. Form 6 in the Appendix of Forms meets the requirements for a certificate of compliance.

CREDIT(S)

(As amended Apr. 24, 1998, eff. Dec. 1, 1998; Apr. 29, 2002, eff. Dec. 1, 2002; Apr. 25, 2005, eff. Dec. 1, 2005; Apr. 28, 2016, eff. Dec. 1, 2016; Apr. 25, 2019, eff. Dec. 1, 2019.)

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Unconstitutional or PreemptedNegative Treatment Reconsidered by Florida ex rel. Atty. Gen. v. U.S. Dept. of Health and Human Services, 11th Cir.(Fla.), Aug. 12, 2011

United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle A. Income Taxes (Refs & Annos)
Chapter 1. Normal Taxes and Surtaxes (Refs & Annos)
Subchapter B. Computation of Taxable Income
Part VI. Itemized Deductions for Individuals and Corporations (Refs & Annos)

26 U.S.C.A. § 162, I.R.C. § 162

§ 162. Trade or business expenses

Effective: December 22, 2017
Currentness

(a) In general.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes. For purposes of paragraph (2), the taxpayer shall not be treated as being temporarily away from home during any period of employment if such period exceeds 1 year. The preceding sentence shall not apply to any Federal employee during any period for which such employee is certified by the Attorney General (or the designee thereof) as traveling on behalf of the United States in temporary duty status to investigate or prosecute, or provide support services for the investigation or prosecution of, a Federal crime.

(b) Charitable contributions and gifts excepted.--No deduction shall be allowed under subsection (a) for any contribution or gift which would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar limitations, or the requirements as to the time of payment, set forth in such section.

(c) Illegal bribes, kickbacks, and other payments.--

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(1) Illegal payments to government officials or employees.--No deduction shall be allowed under subsection (a) for any payment made, directly or indirectly, to an official or employee of any government, or of any agency or instrumentality of any government, if the payment constitutes an illegal bribe or kickback or, if the payment is to an official or employee of a foreign government, the payment is unlawful under the Foreign Corrupt Practices Act of 1977. The burden of proof in respect of the issue, for the purposes of this paragraph, as to whether a payment constitutes an illegal bribe or kickback (or is unlawful under the Foreign Corrupt Practices Act of 1977) shall be upon the Secretary to the same extent as he bears the burden of proof under section 7454 (concerning the burden of proof when the issue relates to fraud).

(2) Other illegal payments.--No deduction shall be allowed under subsection (a) for any payment (other than a payment described in paragraph (1)) made, directly or indirectly, to any person, if the payment constitutes an illegal bribe, illegal kickback, or other illegal payment under any law of the United States, or under any law of a State (but only if such State law is generally enforced), which subjects the payor to a criminal penalty or the loss of license or privilege to engage in a trade or business. For purposes of this paragraph, a kickback includes a payment in consideration of the referral of a client, patient, or customer. The burden of proof in respect of the issue, for purposes of this paragraph, as to whether a payment constitutes an illegal bribe, illegal kickback, or other illegal payment shall be upon the Secretary to the same extent as he bears the burden of proof under section 7454 (concerning the burden of proof when the issue relates to fraud).

(3) Kickbacks, rebates, and bribes under medicare and medicaid.--No deduction shall be allowed under subsection (a) for any kickback, rebate, or bribe made by any provider of services, supplier, physician, or other person who furnishes items or services for which payment is or may be made under the Social Security Act, or in whole or in part out of Federal funds under a State plan approved under such Act, if such kickback, rebate, or bribe is made in connection with the furnishing of such items or services or the making or receipt of such payments. For purposes of this paragraph, a kickback includes a payment in consideration of the referral of a client, patient, or customer.

(d) Capital contributions to Federal National Mortgage Association.--For purposes of this subtitle, whenever the amount of capital contributions evidenced by a share of stock issued pursuant to section 303(c) of the Federal National Mortgage Association Charter Act (12 U.S.C., sec. 1718) exceeds the fair market value of the stock as of the issue date of such stock, the initial holder of the stock shall treat the excess as ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business.

(e) Denial of deduction for certain lobbying and political expenditures.--

(1) In general.--No deduction shall be allowed under subsection (a) for any amount paid or incurred in connection with--

(A) influencing legislation,

(B) participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office,

(C) any attempt to influence the general public, or segments thereof, with respect to elections, legislative matters, or referendums, or

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(D) any direct communication with a covered executive branch official in an attempt to influence the official actions or positions of such official.

(2) Application to dues of tax-exempt organizations.--No deduction shall be allowed under subsection (a) for the portion of dues or other similar amounts paid by the taxpayer to an organization which is exempt from tax under this subtitle which the organization notifies the taxpayer under section 6033(e)(1)(A)(ii) is allocable to expenditures to which paragraph (1) applies.

(3) Influencing legislation.--For purposes of this subsection--

(A) In general.--The term "influencing legislation" means any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation.

(B) Legislation.--The term "legislation" has the meaning given such term by section 4911(e)(2).

(4) Other special rules.--

(A) Exception for certain taxpayers.--In the case of any taxpayer engaged in the trade or business of conducting activities described in paragraph (1), paragraph (1) shall not apply to expenditures of the taxpayer in conducting such activities directly on behalf of another person (but shall apply to payments by such other person to the taxpayer for conducting such activities).

(B) De minimis exception.--

(i) In general.--Paragraph (1) shall not apply to any in-house expenditures for any taxable year if such expenditures do not exceed $2,000. In determining whether a taxpayer exceeds the $2,000 limit under this clause, there shall not be taken into account overhead costs otherwise allocable to activities described in paragraphs (1)(A) and (D).

(ii) In-house expenditures.--For purposes of clause (i), the term "in-house expenditures" means expenditures described in paragraphs (1)(A) and (D) other than--

(I) payments by the taxpayer to a person engaged in the trade or business of conducting activities described in paragraph (1) for the conduct of such activities on behalf of the taxpayer, or

(II) dues or other similar amounts paid or incurred by the taxpayer which are allocable to activities described in paragraph (1).

(C) Expenses incurred in connection with lobbying and political activities.--Any amount paid or incurred for research for, or preparation, planning, or coordination of, any activity described in paragraph (1) shall be treated as paid or incurred in connection with such activity.

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(5) Covered executive branch official.--For purposes of this subsection, the term "covered executive branch official" means--

(A) the President,

(B) the Vice President,

(C) any officer or employee of the White House Office of the Executive Office of the President, and the 2 most senior level officers of each of the other agencies in such Executive Office, and

(D) **(i)** any individual serving in a position in level I of the Executive Schedule under section 5312 of title 5, United States Code, (ii) any other individual designated by the President as having Cabinet level status, and (iii) any immediate deputy of an individual described in clause (i) or (ii).

(6) Cross reference.--

For reporting requirements and alternative taxes related to this subsection, see section 6033(e).

[**(7) Repealed.** Pub.L. 115-97, Title I, § 13308(a), Dec. 22, 2017, 131 Stat. 2129]

[(8) Redesignated (6)]

(f) Fines, penalties, and other amounts.--

(1) In general.--Except as provided in the following paragraphs of this subsection, no deduction otherwise allowable shall be allowed under this chapter for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

(2) Exception for amounts constituting restitution or paid to come into compliance with law.--

(A) In general.--Paragraph (1) shall not apply to any amount that--

(i) the taxpayer establishes--

(I) constitutes restitution (including remediation of property) for damage or harm which was or may be caused by the violation of any law or the potential violation of any law, or

(II) is paid to come into compliance with any law which was violated or otherwise involved in the investigation or inquiry described in paragraph (1),

(ii) is identified as restitution or as an amount paid to come into compliance with such law, as the case may be, in the court order or settlement agreement, and

(iii) in the case of any amount of restitution for failure to pay any tax imposed under this title in the same manner as if such amount were such tax, would have been allowed as a deduction under this chapter if it had been timely paid.

The identification under clause (ii) alone shall not be sufficient to make the establishment required under clause (i).

(B) Limitation.--Subparagraph (A) shall not apply to any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.

(3) Exception for amounts paid or incurred as the result of certain court orders.--Paragraph (1) shall not apply to any amount paid or incurred by reason of any order of a court in a suit in which no government or governmental entity is a party.

(4) Exception for taxes due.--Paragraph (1) shall not apply to any amount paid or incurred as taxes due.

(5) Treatment of certain nongovernmental regulatory entities.--For purposes of this subsection, the following nongovernmental entities shall be treated as governmental entities:

(A) Any nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)).

(B) To the extent provided in regulations, any nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) as part of performing an essential governmental function.

(g) Treble damage payments under the antitrust laws.--If in a criminal proceeding a taxpayer is convicted of a violation of the antitrust laws, or his plea of guilty or nolo contendere to an indictment or information charging such a violation is entered or accepted in such a proceeding, no deduction shall be allowed under subsection (a) for two-thirds of any amount paid or incurred--

(1) on any judgment for damages entered against the taxpayer under section 4 of the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes", approved October 15, 1914 (commonly known as the Clayton Act), on account of such violation or any related violation of the antitrust laws which occurred prior to the date of the final judgment of such conviction, or

(2) in settlement of any action brought under such section 4 on account of such violation or related violation.

(h) State legislators' travel expenses away from home.--

(1) In general.--For purposes of subsection (a), in the case of any individual who is a State legislator at any time during the taxable year and who makes an election under this subsection for the taxable year--

(A) the place of residence of such individual within the legislative district which he represented shall be considered his home,

(B) he shall be deemed to have expended for living expenses (in connection with his trade or business as a legislator) an amount equal to the sum of the amounts determined by multiplying each legislative day of such individual during the taxable year by the greater of--

(i) the amount generally allowable with respect to such day to employees of the State of which he is a legislator for per diem while away from home, to the extent such amount does not exceed 110 percent of the amount described in clause (ii) with respect to such day, or

(ii) the amount generally allowable with respect to such day to employees of the executive branch of the Federal Government for per diem while away from home but serving in the United States, and

(C) he shall be deemed to be away from home in the pursuit of a trade or business on each legislative day.

(2) Legislative days.--For purposes of paragraph (1), a legislative day during any taxable year for any individual shall be any day during such year on which--

(A) the legislature was in session (including any day in which the legislature was not in session for a period of 4 consecutive days or less), or

(B) the legislature was not in session but the physical presence of the individual was formally recorded at a meeting of a committee of such legislature.

(3) Election.--An election under this subsection for any taxable year shall be made at such time and in such manner as the Secretary shall by regulations prescribe.

(4) Section not to apply to legislators who reside near capitol.--This subsection shall not apply to any legislator whose place of residence within the legislative district which he represents is 50 or fewer miles from the capitol building of the State.

[(i) Repealed. Pub.L. 101-239, Title VI, § 6202(b)(3)(A), Dec. 19, 1989, 103 Stat. 2233]

(j) Certain foreign advertising expenses.--

(1) In general.--No deduction shall be allowed under subsection (a) for any expenses of an advertisement carried by a foreign broadcast undertaking and directed primarily to a market in the United States. This paragraph shall apply only to foreign broadcast undertakings located in a country which denies a similar deduction for the cost of advertising directed primarily to a market in the foreign country when placed with a United States broadcast undertaking.

(2) Broadcast undertaking.--For purposes of paragraph (1), the term "broadcast undertaking" includes (but is not limited to) radio and television stations.

(k) Stock reacquisition expenses.--

(1) In general.--Except as provided in paragraph (2), no deduction otherwise allowable shall be allowed under this chapter for any amount paid or incurred by a corporation in connection with the reacquisition of its stock or of the stock of any related person (as defined in section 465(b)(3)(C)).

(2) Exceptions.--Paragraph (1) shall not apply to--

(A) Certain specific deductions.--Any--

(i) deduction allowable under section 163 (relating to interest),

(ii) deduction for amounts which are properly allocable to indebtedness and amortized over the term of such indebtedness, or

(iii) deduction for dividends paid (within the meaning of section 561).

(B) Stock of certain regulated investment companies.--Any amount paid or incurred in connection with the redemption of any stock in a regulated investment company which issues only stock which is redeemable upon the demand of the shareholder.

(l) Special rules for health insurance costs of self-employed individuals.--

(1) Allowance of deduction.--In the case of a taxpayer who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to the amount paid during the taxable year for insurance which constitutes medical care for--

(A) the taxpayer,

(B) the taxpayer's spouse,

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(C) the taxpayer's dependents, and

(D) any child (as defined in section 152(f)(1)) of the taxpayer who as of the end of the taxable year has not attained age 27.

(2) Limitations.--

(A) Dollar amount.--No deduction shall be allowed under paragraph (1) to the extent that the amount of such deduction exceeds the taxpayer's earned income (within the meaning of section 401(c)) derived by the taxpayer from the trade or business with respect to which the plan providing the medical care coverage is established.

(B) Other coverage.--Paragraph (1) shall not apply to any taxpayer for any calendar month for which the taxpayer is eligible to participate in any subsidized health plan maintained by any employer of the taxpayer or of the spouse of, or any dependent, or individual described in subparagraph (D) of paragraph (1) with respect to, the taxpayer. The preceding sentence shall be applied separately with respect to--

(i) plans which include coverage for qualified long-term care services (as defined in section 7702B(c)) or are qualified long-term care insurance contracts (as defined in section 7702B(b)), and

(ii) plans which do not include such coverage and are not such contracts.

(C) Long-term care premiums.--In the case of a qualified long-term care insurance contract (as defined in section 7702B(b)), only eligible long-term care premiums (as defined in section 213(d)(10)) shall be taken into account under paragraph (1).

(3) Coordination with medical deduction.--Any amount paid by a taxpayer for insurance to which paragraph (1) applies shall not be taken into account in computing the amount allowable to the taxpayer as a deduction under section 213(a).

(4) Deduction not allowed for self-employment tax purposes.--The deduction allowable by reason of this subsection shall not be taken into account in determining an individual's net earnings from self-employment (within the meaning of section 1402(a)) for purposes of chapter 2 for taxable years beginning before January 1, 2010, or after December 31, 2010.

(5) Treatment of certain S corporation shareholders.--This subsection shall apply in the case of any individual treated as a partner under section 1372(a), except that--

(A) for purposes of this subsection, such individual's wages (as defined in section 3121) from the S corporation shall be treated as such individual's earned income (within the meaning of section 401(c)(1)), and

(B) there shall be such adjustments in the application of this subsection as the Secretary may by regulations prescribe.

(m) Certain excessive employee remuneration.--

(1) In general.--In the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds $1,000,000.

(2) Publicly held corporation.--For purposes of this subsection, the term "publicly held corporation" means any corporation which is an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c))--

(A) the securities of which are required to be registered under section 12 of such Act (15 U.S.C. 78*l*), or

(B) that is required to file reports under section 15(d) of such Act (15 U.S.C. 78*o*(d)).

(3) Covered employee.--For purposes of this subsection, the term "covered employee" means any employee of the taxpayer if--

(A) such employee is the principal executive officer or principal financial officer of the taxpayer at any time during the taxable year, or was an individual acting in such a capacity,

(B) the total compensation of such employee for the taxable year is required to be reported to shareholders under the Securities Exchange Act of 1934 by reason of such employee being among the 3 highest compensated officers for the taxable year (other than any individual described in subparagraph (A)), or

(C) was a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

Such term shall include any employee who would be described in subparagraph (B) if the reporting described in such subparagraph were required as so described.

(4) Applicable employee remuneration.--For purposes of this subsection--

(A) In general.--Except as otherwise provided in this paragraph, the term "applicable employee remuneration" means, with respect to any covered employee for any taxable year, the aggregate amount allowable as a deduction under this chapter for such taxable year (determined without regard to this subsection) for remuneration for services performed by such employee (whether or not during the taxable year).

(B) Exception for existing binding contracts.--The term "applicable employee remuneration" shall not include any remuneration payable under a written binding contract which was in effect on February 17, 1993, and which was not modified thereafter in any material respect before such remuneration is paid.

(C) Remuneration.--For purposes of this paragraph, the term "remuneration" includes any remuneration (including benefits) in any medium other than cash, but shall not include--

(i) any payment referred to in so much of section 3121(a)(5) as precedes subparagraph (E) thereof, and

(ii) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from gross income under this chapter.

For purposes of clause (i), section 3121(a)(5) shall be applied without regard to section 3121(v)(1).

(D) Coordination with disallowed golden parachute payments.--The dollar limitation contained in paragraph (1) shall be reduced (but not below zero) by the amount (if any) which would have been included in the applicable employee remuneration of the covered employee for the taxable year but for being disallowed under section 280G.

(E) Coordination with excise tax on specified stock compensation.--The dollar limitation contained in paragraph (1) with respect to any covered employee shall be reduced (but not below zero) by the amount of any payment (with respect to such employee) of the tax imposed by section 4985 directly or indirectly by the expatriated corporation (as defined in such section) or by any member of the expanded affiliated group (as defined in such section) which includes such corporation.

(F) Special rule for remuneration paid to beneficiaries, etc.--Remuneration shall not fail to be applicable employee remuneration merely because it is includible in the income of, or paid to, a person other than the covered employee, including after the death of the covered employee.

[(G) Redesignated (E)]

(5) Special rule for application to employers participating in the Troubled Assets Relief Program.--

(A) In general.--In the case of an applicable employer, no deduction shall be allowed under this chapter--

(i) in the case of executive remuneration for any applicable taxable year which is attributable to services performed by a covered executive during such applicable taxable year, to the extent that the amount of such remuneration exceeds $500,000, or

(ii) in the case of deferred deduction executive remuneration for any taxable year for services performed during any applicable taxable year by a covered executive, to the extent that the amount of such remuneration exceeds $500,000 reduced (but not below zero) by the sum of--

(I) the executive remuneration for such applicable taxable year, plus

(II) the portion of the deferred deduction executive remuneration for such services which was taken into account under this clause in a preceding taxable year.

(B) Applicable employer.--For purposes of this paragraph--

(i) In general.--Except as provided in clause (ii), the term "applicable employer" means any employer from whom 1 or more troubled assets are acquired under a program established by the Secretary under section 101(a) of the Emergency Economic Stabilization Act of 2008 if the aggregate amount of the assets so acquired for all taxable years exceeds $300,000,000.

(ii) Disregard of certain assets sold through direct purchase.--If the only sales of troubled assets by an employer under the program described in clause (i) are through 1 or more direct purchases (within the meaning of section 113(c) of the Emergency Economic Stabilization Act of 2008), such assets shall not be taken into account under clause (i) in determining whether the employer is an applicable employer for purposes of this paragraph.

(iii) Aggregation rules.--Two or more persons who are treated as a single employer under subsection (b) or (c) of section 414 shall be treated as a single employer, except that in applying section 1563(a) for purposes of either such subsection, paragraphs (2) and (3) thereof shall be disregarded.

(C) Applicable taxable year.--For purposes of this paragraph, the term "applicable taxable year" means, with respect to any employer--

(i) the first taxable year of the employer--

(I) which includes any portion of the period during which the authorities under section 101(a) of the Emergency Economic Stabilization Act of 2008 are in effect (determined under section 120 thereof), and

(II) in which the aggregate amount of troubled assets acquired from the employer during the taxable year pursuant to such authorities (other than assets to which subparagraph (B)(ii) applies), when added to the aggregate amount so acquired for all preceding taxable years, exceeds $300,000,000, and

(ii) any subsequent taxable year which includes any portion of such period.

(D) Covered executive.--For purposes of this paragraph--

(i) In general.--The term "covered executive" means, with respect to any applicable taxable year, any employee--

(I) who, at any time during the portion of the taxable year during which the authorities under section 101(a) of the Emergency Economic Stabilization Act of 2008 are in effect (determined under section 120 thereof), is the chief

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executive officer of the applicable employer or the chief financial officer of the applicable employer, or an individual acting in either such capacity, or

(II) who is described in clause (ii).

(ii) Highest compensated employees.--An employee is described in this clause if the employee is 1 of the 3 highest compensated officers of the applicable employer for the taxable year (other than an individual described in clause (i)(I)), determined--

(I) on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (without regard to whether those rules apply to the employer), and

(II) by only taking into account employees employed during the portion of the taxable year described in clause (i)(I).

(iii) Employee remains covered executive.--If an employee is a covered executive with respect to an applicable employer for any applicable taxable year, such employee shall be treated as a covered executive with respect to such employer for all subsequent applicable taxable years and for all subsequent taxable years in which deferred deduction executive remuneration with respect to services performed in all such applicable taxable years would (but for this paragraph) be deductible.

(E) Executive remuneration.--For purposes of this paragraph, the term "executive remuneration" means the applicable employee remuneration of the covered executive, as determined under paragraph (4) without regard to subparagraph (B) thereof. Such term shall not include any deferred deduction executive remuneration with respect to services performed in a prior applicable taxable year.

(F) Deferred deduction executive remuneration.--For purposes of this paragraph, the term "deferred deduction executive remuneration" means remuneration which would be executive remuneration for services performed in an applicable taxable year but for the fact that the deduction under this chapter (determined without regard to this paragraph) for such remuneration is allowable in a subsequent taxable year.

(G) Coordination.--Rules similar to the rules of subparagraphs (D) and (E) of paragraph (4) shall apply for purposes of this paragraph.

(H) Regulatory authority.--The Secretary may prescribe such guidance, rules, or regulations as are necessary to carry out the purposes of this paragraph and the Emergency Economic Stabilization Act of 2008, including the extent to which this paragraph applies in the case of any acquisition, merger, or reorganization of an applicable employer.

(6) Special rule for application to certain health insurance providers--

(A) In general.--No deduction shall be allowed under this chapter--

(i) in the case of applicable individual remuneration which is for any disqualified taxable year beginning after December 31, 2012, and which is attributable to services performed by an applicable individual during such taxable year, to the extent that the amount of such remuneration exceeds $500,000, or

(ii) in the case of deferred deduction remuneration for any taxable year beginning after December 31, 2012, which is attributable to services performed by an applicable individual during any disqualified taxable year beginning after December 31, 2009, to the extent that the amount of such remuneration exceeds $500,000 reduced (but not below zero) by the sum of--

(I) the applicable individual remuneration for such disqualified taxable year, plus

(II) the portion of the deferred deduction remuneration for such services which was taken into account under this clause in a preceding taxable year (or which would have been taken into account under this clause in a preceding taxable year if this clause were applied by substituting "December 31, 2009" for "December 31, 2012" in the matter preceding subclause (I)).

(B) Disqualified taxable year.--For purposes of this paragraph, the term "disqualified taxable year" means, with respect to any employer, any taxable year for which such employer is a covered health insurance provider.

(C) Covered health insurance provider.--For purposes of this paragraph--

(i) In general.--The term "covered health insurance provider" means--

(I) with respect to taxable years beginning after December 31, 2009, and before January 1, 2013, any employer which is a health insurance issuer (as defined in section 9832(b)(2)) and which receives premiums from providing health insurance coverage (as defined in section 9832(b)(1)), and

(II) with respect to taxable years beginning after December 31, 2012, any employer which is a health insurance issuer (as defined in section 9832(b)(2)) and with respect to which not less than 25 percent of the gross premiums received from providing health insurance coverage (as defined in section 9832(b)(1)) is from minimum essential coverage (as defined in section 5000A(f)).

(ii) Aggregation rules.--Two or more persons who are treated as a single employer under subsection (b), (c), (m), or (o) of section 414 shall be treated as a single employer, except that in applying section 1563(a) for purposes of any such subsection, paragraphs (2) and (3) thereof shall be disregarded.

(D) Applicable individual remuneration.--For purposes of this paragraph, the term "applicable individual remuneration" means, with respect to any applicable individual for any disqualified taxable year, the aggregate amount allowable as a deduction under this chapter for such taxable year (determined without regard to this subsection) for remuneration (as defined in paragraph (4) without regard to subparagraph (B) thereof) for services performed by such individual (whether or not during the taxable year). Such term shall not include any deferred deduction remuneration with respect to services performed during the disqualified taxable year.

(E) Deferred deduction remuneration.--For purposes of this paragraph, the term "deferred deduction remuneration" means remuneration which would be applicable individual remuneration for services performed in a disqualified taxable year but for the fact that the deduction under this chapter (determined without regard to this paragraph) for such remuneration is allowable in a subsequent taxable year.

(F) Applicable individual.--For purposes of this paragraph, the term "applicable individual" means, with respect to any covered health insurance provider for any disqualified taxable year, any individual--

(i) who is an officer, director, or employee in such taxable year, or

(ii) who provides services for or on behalf of such covered health insurance provider during such taxable year.

(G) Coordination.--Rules similar to the rules of subparagraphs (D) and (E) of paragraph (4) shall apply for purposes of this paragraph.

(H) Regulatory authority.--The Secretary may prescribe such guidance, rules, or regulations as are necessary to carry out the purposes of this paragraph.

(n) Special rule for certain group health plans.--

(1) In general.--No deduction shall be allowed under this chapter to an employer for any amount paid or incurred in connection with a group health plan if the plan does not reimburse for inpatient hospital care services provided in the State of New York--

(A) except as provided in subparagraphs (B) and (C), at the same rate as licensed commercial insurers are required to reimburse hospitals for such services when such reimbursement is not through such a plan,

(B) in the case of any reimbursement through a health maintenance organization, at the same rate as health maintenance organizations are required to reimburse hospitals for such services for individuals not covered by such a plan (determined without regard to any government-supported individuals exempt from such rate), or

(C) in the case of any reimbursement through any corporation organized under Article 43 of the New York State Insurance Law, at the same rate as any such corporation is required to reimburse hospitals for such services for individuals not covered by such a plan.

(2) State law exception.--Paragraph (1) shall not apply to any group health plan which is not required under the laws of the State of New York (determined without regard to this subsection or other provisions of Federal law) to reimburse at the rates provided in paragraph (1).

(3) Group health plan.--For purposes of this subsection, the term "group health plan" means a plan of, or contributed to by, an employer or employee organization (including a self-insured plan) to provide health care (directly or otherwise) to any employee, any former employee, the employer, or any other individual associated or formerly associated with the employer in a business relationship, or any member of their family.

(o) Treatment of certain expenses of rural mail carriers.--

(1) General rule.--In the case of any employee of the United States Postal Service who performs services involving the collection and delivery of mail on a rural route and who receives qualified reimbursements for the expenses incurred by such employee for the use of a vehicle in performing such services--

(A) the amount allowable as a deduction under this chapter for the use of a vehicle in performing such services shall be equal to the amount of such qualified reimbursements; and

(B) such qualified reimbursements shall be treated as paid under a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) (and section 62(c) shall not apply to such qualified reimbursements).

(2) Special rule where expenses exceed reimbursements.--Notwithstanding paragraph (1)(A), if the expenses incurred by an employee for the use of a vehicle in performing services described in paragraph (1) exceed the qualified reimbursements for such expenses, such excess shall be taken into account in computing the miscellaneous itemized deductions of the employee under section 67.

(3) Definition of qualified reimbursements.--For purposes of this subsection, the term "qualified reimbursements" means the amounts paid by the United States Postal Service to employees as an equipment maintenance allowance under the 1991 collective bargaining agreement between the United States Postal Service and the National Rural Letter Carriers' Association. Amounts paid as an equipment maintenance allowance by such Postal Service under later collective bargaining agreements that supersede the 1991 agreement shall be considered qualified reimbursements if such amounts do not exceed the amounts that would have been paid under the 1991 agreement, adjusted by increasing any such amount under the 1991 agreement by an amount equal to--

(A) such amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 1990" for "calendar year 2016" in subparagraph (A)(ii) thereof.

(p) Treatment of expenses of members of reserve component of Armed Forces of the United States.--For purposes of subsection (a)(2), in the case of an individual who performs services as a member of a reserve component of the Armed Forces of the United States at any time during the taxable year, such individual shall be deemed to be away from home in the pursuit of a trade or business for any period during which such individual is away from home in connection with such service.

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(q) Payments related to sexual harassment and sexual abuse.--No deduction shall be allowed under this chapter for--

(1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or

(2) attorney's fees related to such a settlement or payment.

(r) Disallowance of FDIC premiums paid by certain large financial institutions.--

(1) In general.--No deduction shall be allowed for the applicable percentage of any FDIC premium paid or incurred by the taxpayer.

(2) Exception for small institutions.--Paragraph (1) shall not apply to any taxpayer for any taxable year if the total consolidated assets of such taxpayer (determined as of the close of such taxable year) do not exceed $10,000,000,000.

(3) Applicable percentage.--For purposes of this subsection, the term "applicable percentage" means, with respect to any taxpayer for any taxable year, the ratio (expressed as a percentage but not greater than 100 percent) which--

(A) the excess of--

(i) the total consolidated assets of such taxpayer (determined as of the close of such taxable year), over

(ii) $10,000,000,000, bears to

(B) $40,000,000,000.

(4) FDIC premiums.--For purposes of this subsection, the term "FDIC premium" means any assessment imposed under section 7(b) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)).

(5) Total consolidated assets.--For purposes of this subsection, the term "total consolidated assets" has the meaning given such term under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5365).

(6) Aggregation rule.--

(A) In general.--Members of an expanded affiliated group shall be treated as a single taxpayer for purposes of applying this subsection.

(B) Expanded affiliated group.--

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(i) In general.--For purposes of this paragraph, the term "expanded affiliated group" means an affiliated group as defined in section 1504(a), determined--

(I) by substituting "more than 50 percent" for "at least 80 percent" each place it appears, and

(II) without regard to paragraphs (2) and (3) of section 1504(b).

(ii) Control of non-corporate entities.--A partnership or any other entity (other than a corporation) shall be treated as a member of an expanded affiliated group if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this clause).

(s) Cross reference.--

(1) For special rule relating to expenses in connection with subdividing real property for sale, see section 1237.

(2) For special rule relating to the treatment of payments by a transferee of a franchise, trademark, or trade name, see section 1253.

(3) For special rules relating to--

(A) funded welfare benefit plans, see section 419, and

(B) deferred compensation and other deferred benefits, see section 404.

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 45; Pub.L. 85-866, Title I, § 5(a), Sept. 2, 1958, 72 Stat. 1608; Pub.L. 86-779, §§ 7(b), 8(a), Sept. 14, 1960, 74 Stat. 1002, 1003; Pub.L. 87-834, §§ 3(a), 4(b), Oct. 16, 1962, 76 Stat. 973, 976; Pub.L. 91-172, Title V, § 516(c)(2)(A), Title IX, § 902(a), (b), Dec. 30, 1969, 83 Stat. 648, 710; Pub.L. 92-178, Title III, § 310(a), Dec. 10, 1971, 85 Stat. 525; Pub.L. 94-455, Title XIX, §§ 1901(c)(4), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1803, 1834; Pub.L. 97-34, Title I, § 127(a), Aug. 13, 1981, 95 Stat. 202; Pub.L. 97-35, Title XXI, § 2146(b), Aug. 13, 1981, 95 Stat. 801; Pub.L. 97-51, § 139(b)(1), Oct. 1, 1981, 95 Stat. 967; Pub.L. 97-216, Title II, § 215(a), July 19, 1982, 96 Stat. 194; Pub.L. 97-248, Title I, § 128(b), Title II, § 288(a), Sept. 3, 1982, 96 Stat. 366, 571; Pub.L. 98-369, Div. A, Title V, § 512(b), Div. B, Title III, § 2354(d), July 18, 1984, 98 Stat. 863, 1102; Pub.L. 98-573, Title II, § 232(a), Oct. 30, 1984, 98 Stat. 2991; Pub.L. 99-272, Title X, § 10001(a), (c), (d), Apr. 7, 1986, 100 Stat. 222, 223 to 227; Pub.L. 99-509, Title IX, § 9501(a)(1), (b)(1)(A), (2)(A), (c)(1), (d)(1), Oct. 21, 1986, 100 Stat. 1995, 2075 to 2077; Pub.L. 99-514, Title VI, § 613(a), Title XI, § 1161(a), Title XVIII, § 1895(d)(1)(A), (2)(A), (3)(A), (4)(A), (5)(A), (6)(A), (7), Oct. 22, 1986, 100 Stat. 2251, 2509, 2936 to 2940; Pub.L. 100-647, Title I, §§ 1011B(b)(1) to (3), 1018(t)(7)(B), Title III, § 3011(b)(2), (3), Nov. 10, 1988, 102 Stat. 3488, 3589, 3624, 3625; Pub.L. 101-140, Title II, § 203(a)(4), Nov. 8, 1989, 103 Stat. 830; Pub.L. 101-239, Title VI, § 6202(b)(3)(A), Title VII, §§ 7107(a)(1), (b), 7862(c)(3)(A), Dec. 19, 1989, 103 Stat. 2233, 2306, 2432; Pub.L. 101-508, Title XI, §§ 11111(d)(2), 11410(a), Nov. 5, 1990, 104 Stat. 1388-413, 1388-479; Pub.L. 102-227, Title I, § 110(a)(1), Dec. 11, 1991, 105 Stat. 1688; Pub.L. 102-486, Title XIX, § 1938(a),

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Oct. 24, 1992, 106 Stat. 3033; Pub.L. 103-66, Title XIII, §§ 13131(d)(2), 13174(a)(1), (b)(1), 13211(a), 13222(a), 13442(a), Aug. 10, 1993, 107 Stat. 435, 457, 469, 477, 568; Pub.L. 104-7, § 1(a), (b), Apr. 11, 1995, 109 Stat. 93; Pub.L. 104-188, Title I, § 1704(p)(1) to (3), Aug. 20, 1996, 110 Stat. 1886; Pub.L. 104-191, Title III, §§ 311(a), 322(b)(2)(B), Aug. 21, 1996, 110 Stat. 2053, 2060; Pub.L. 105-34, Title IX, § 934(a), Title XII, §§ 1203(a), 1204(a), Title XVI, § 1602(c), Aug. 5, 1997, 111 Stat. 882, 994, 995, 1094; Pub.L. 105-206, Title VI, § 6012(a), July 22, 1998, 112 Stat. 818; Pub.L. 105-277, Div. J, Title II, § 2002(a), Oct. 21, 1998, 112 Stat. 2681-901; Pub.L. 108-121, Title I, § 109(a), Nov. 11, 2003, 117 Stat. 1341; Pub.L. 108-357, Title III, § 318(a), (b), Title VIII, § 802(b)(2), Oct. 22, 2004, 118 Stat. 1470, 1568; Pub.L. 110-343, Title III, § 302(a), Oct. 3, 2008, 122 Stat. 3803; Pub.L. 111-148, Title IX, § 9014(a), Title X, § 10108(g)(1), Mar. 23, 2010, 124 Stat. 868, 913; Pub.L. 111-152, Title I, § 1004(d)(2), (3), Mar. 30, 2010, 124 Stat. 1035; Pub.L. 111-240, Title II, § 2042(a), Sept. 27, 2010, 124 Stat. 2560; Pub.L. 112-10, Div. B, Title VIII, § 1858(b)(3), Apr. 15, 2011, 125 Stat. 169; Pub.L. 113-295, Div. A, Title II, § 221(a)(23), (24), Dec. 19, 2014, 128 Stat. 4040; Pub.L. 115-97, Title I, §§ 11002(d)(6), 13306(a)(1), 13307(a), 13308(a), 13311(a), 13531(a), 13601(a) to (d), Dec. 22, 2017, 131 Stat. 2061, 2126, 2129, 2132, 2153, 2155.)

26 U.S.C.A. § 162, 26 USCA § 162
Current through P.L. 116-140.

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Proposed Legislation

United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle A. Income Taxes (Refs & Annos)
Chapter 1. Normal Taxes and Surtaxes (Refs & Annos)
Subchapter B. Computation of Taxable Income
Part IX. Items Not Deductible (Refs & Annos)

26 U.S.C.A. § 263, I.R.C. § 263

§ 263. Capital expenditures

Effective: March 23, 2018
Currentness

(a) General rule.--No deduction shall be allowed for--

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to--

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180,

(E) expenditures for removal of architectural and transportation barriers to the handicapped and elderly which the taxpayer elects to deduct under section 190,

(F) expenditures for tertiary injectants with respect to which a deduction is allowed under section 193,

(G) expenditures for which a deduction is allowed under section 179,

(H) expenditures for which a deduction is allowed under section 179B,

(I) expenditures for which a deduction is allowed under section 179C,

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(J) expenditures for which a deduction is allowed under section 179D, or

(K) expenditures for which a deduction is allowed under section 179E.

[**(L)** Redesignated (K)]

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

[(b) Repealed. Pub.L. 101-508, Title XI, § 11801(a)(16), Nov. 5, 1990, 104 Stat. 1388-520]

(c) Intangible drilling and development costs in the case of oil and gas wells and geothermal wells.--Notwithstanding subsection (a), and except as provided in subsection (i), regulations shall be prescribed by the Secretary under this subtitle corresponding to the regulations which granted the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells and which were recognized and approved by the Congress in House Concurrent Resolution 50, Seventy-ninth Congress. Such regulations shall also grant the option to deduct as expenses intangible drilling and development costs in the case of wells drilled for any geothermal deposit (as defined in section 613(e)(2)) to the same extent and in the same manner as such expenses are deductible in the case of oil and gas wells. This subsection shall not apply with respect to any costs to which any deduction is allowed under section 59(e) or 291.

(d) Expenditures in connection with certain railroad rolling stock.--In the case of expenditures in connection with the rehabilitation of a unit of railroad rolling stock (except a locomotive) used by a domestic common carrier by railroad which would, but for this subsection, be properly chargeable to capital account, such expenditures, if during any 12-month period they do not exceed an amount equal to 20 percent of the basis of such unit in the hands of the taxpayer, shall, at the election of the taxpayer, be treated (notwithstanding subsection (a)) as deductible repairs under section 162 or 212. An election under this subsection shall be made for any taxable year at such time and in such manner as the Secretary prescribes by regulations. An election may not be made under this subsection for any taxable year to which an election under subsection (e) applies to railroad rolling stock (other than locomotives).

[(e) Repealed. Pub.L. 97-34, Title II, § 201(c), Aug. 13, 1981, 95 Stat. 219]

(f) Railroad ties.--In the case of a domestic common carrier by rail (including a railroad switching or terminal company) which uses the retirement-replacement method of accounting for depreciation of its railroad track, expenditures for acquiring and installing replacement ties of any material (and fastenings related to such ties) shall be accorded the same tax accounting treatment as expenditures for replacement ties of wood (and fastenings related to such ties).

(g) Certain interest and carrying costs in the case of straddles.--

(1) General rule.--No deduction shall be allowed for interest and carrying charges properly allocable to personal property which is part of a straddle (as defined in section 1092(c)). Any amount not allowed as a deduction by reason of the preceding sentence shall be chargeable to the capital account with respect to the personal property to which such amount relates.

(2) Interest and carrying charges defined.--For purposes of paragraph (1), the term "interest and carrying charges" means the excess of--

(A) the sum of--

(i) interest on indebtedness incurred or continued to purchase or carry the personal property, and

(ii) all other amounts (including charges to insure, store, or transport the personal property) paid or incurred to carry the personal property, over

(B) the sum of--

(i) the amount of interest (including original issue discount) includible in gross income for the taxable year with respect to the property described in subparagraph (A),

(ii) any amount treated as ordinary income under section 1271(a)(3)(A), 1276, or 1281(a) with respect to such property for the taxable year,

(iii) the excess of any dividends includible in gross income with respect to such property for the taxable year over the amount of any deduction allowable with respect to such dividends under section 243 or 245, and

(iv) any amount which is a payment with respect to a security loan (within the meaning of section 512(a)(5)) includible in gross income with respect to such property for the taxable year.

For purposes of subparagraph (A), the term "interest" includes any amount paid or incurred in connection with personal property used in a short sale.

(3) Exception for hedging transactions.--This subsection shall not apply in the case of any hedging transaction (as defined in section 1256(e)).

(4) Application with other provisions.--

(A) Subsection (c).--In the case of any short sale, this subsection shall be applied after subsection (h).

(B) Section 1277 or 1282.--In the case of any obligation to which section 1277 or 1282 applies, this subsection shall be applied after section 1277 or 1282.

(h) Payments in lieu of dividends in connection with short sales.--

(1) In general.--If--

(A) a taxpayer makes any payment with respect to any stock used by such taxpayer in a short sale and such payment is in lieu of a dividend payment on such stock, and

(B) the closing of such short sale occurs on or before the 45th day after the date of such short sale,

then no deduction shall be allowed for such payment. The basis of the stock used to close the short sale shall be increased by the amount not allowed as a deduction by reason of the preceding sentence.

(2) Longer period in case of extraordinary dividends.--If the payment described in paragraph (1)(A) is in respect of an extraordinary dividend, paragraph (1)(B) shall be applied by substituting "the day 1 year after the date of such short sale" for "the 45th day after the date of such short sale".

(3) Extraordinary dividend.--For purposes of this subsection, the term "extraordinary dividend" has the meaning given to such term by section 1059(c); except that such section shall be applied by treating the amount realized by the taxpayer in the short sale as his adjusted basis in the stock.

(4) Special rule where risk of loss diminished.--The running of any period of time applicable under paragraph (1)(B) (as modified by paragraph (2)) shall be suspended during any period in which--

(A) the taxpayer holds, has an option to buy, or is under a contractual obligation to buy, substantially identical stock or securities, or

(B) under regulations prescribed by the Secretary, a taxpayer has diminished his risk of loss by holding 1 or more other positions with respect to substantially similar or related property.

(5) Deduction allowable to extent of ordinary income from amounts paid by lending broker for use of collateral.--

(A) In general.--Paragraph (1) shall apply only to the extent that the payments or distributions with respect to any short sale exceed the amount which--

(i) is treated as ordinary income by the taxpayer, and

(ii) is received by the taxpayer as compensation for the use of any collateral with respect to any stock used in such short sale.

(B) Exception not to apply to extraordinary dividends.--Subparagraph (A) shall not apply if one or more payments or distributions is in respect of an extraordinary dividend.

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(6) Application of this subsection with subsection (g).--In the case of any short sale, this subsection shall be applied before subsection (g).

(i) Special rules for intangible drilling and development costs incurred outside the United States.--In the case of intangible drilling and development costs paid or incurred with respect to an oil, gas, or geothermal well located outside the United States--

(1) subsection (c) shall not apply, and

(2) such costs shall--

(A) at the election of the taxpayer, be included in adjusted basis for purposes of computing the amount of any deduction allowable under section 611 (determined without regard to section 613), or

(B) if subparagraph (A) does not apply, be allowed as a deduction ratably over the 10-taxable year period beginning with the taxable year in which such costs were paid or incurred.

This subsection shall not apply to costs paid or incurred with respect to a nonproductive well.

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 77; Pub.L. 86-779, § 6(c), Sept. 14, 1960, 74 Stat. 1001; Pub.L. 87-834, § 21(b), Oct. 16, 1962, 76 Stat. 1064; Pub.L. 88-563, § 4, Sept. 2, 1964, 78 Stat. 845; Pub.L. 89-243, § 4(p)(1), (2), Oct. 9, 1965, 79 Stat. 964; Pub.L. 91-172, Title VII, § 706(a), Dec. 30, 1969, 83 Stat. 674; Pub.L. 92-178, Title I, § 109(b), (c), Dec. 10, 1971, 85 Stat. 509; Pub.L. 94-455, Title XVII, § 1701(a), Title XIX, §§ 1904(b)(10)(A)(i), 1906(b)(13)(A), Title XXI, § 2122(b)(2), Oct. 4, 1976, 90 Stat. 1759, 1817, 1834, 1915; Pub.L. 95-618, Title IV, § 402(a), Nov. 9, 1978, 92 Stat. 3201; Pub.L. 96-223, Title II, § 251(a)(2)(B), Apr. 2, 1980, 94 Stat. 287; Pub.L. 97-34, Title II, §§ 201(c), 202(d)(1), Title V, § 502, Aug. 13, 1981, 95 Stat. 219, 221, 327; Pub.L. 97-248, Title II, § 204(c)(1), Sept. 3, 1982, 96 Stat. 426; Pub.L. 97-448, Title I, § 105(b)(1), Title III, § 306(a)(9)(A), Jan. 12, 1983, 96 Stat. 2385, 2403; Pub.L. 98-369, Div. A, Title I, §§ 56(a), 102(e)(7), (8), July 18, 1984, 98 Stat. 573, 624, 625; Pub.L. 99-514, Title IV, §§ 402(b)(1), 411(b)(1), Title VII, § 701(e)(4)(D), Title XVIII, § 1808(b), Oct. 22, 1986, 100 Stat. 2221, 2225, 2343, 2817; Pub.L. 100-647, Title I, § 1007(g)(5), Nov. 10, 1988, 102 Stat. 3435; Pub.L. 101-508, Title XI, §§ 11801(a)(16), 11815(b)(3), Nov. 5, 1990, 104 Stat. 1388-520, 1388-558; Pub.L. 105-34, Title XVI, § 1604(a)(1), Aug. 5, 1997, 111 Stat. 1097; Pub.L. 108-311, Title IV, § 408(a)(10), Oct. 4, 2004, 118 Stat. 1191; Pub.L. 108-357, Title III, § 338(b)(1), Oct. 22, 2004, 118 Stat. 1481; Pub.L. 109-58, Title XIII, §§ 1323(b)(2), 1331(b)(4), Aug. 8, 2005, 119 Stat. 1015, 1024; Pub.L. 109-432, Div. A, Title IV, § 404(b)(1), Dec. 20, 2006, 120 Stat. 2956; Pub.L. 113-295, Div. A, Title II, § 221(a)(34)(D), (41)(G), Dec. 19, 2014, 128 Stat. 4042, 4044; Pub.L. 115-141, Div. U, Title IV, § 401(a)(60), (61), Mar. 23, 2018, 132 Stat. 1187.)

26 U.S.C.A. § 263, 26 USCA § 263
Current through P.L. 116-140.

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United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle A. Income Taxes (Refs & Annos)
Chapter 1. Normal Taxes and Surtaxes (Refs & Annos)
Subchapter B. Computation of Taxable Income
Part IX. Items Not Deductible (Refs & Annos)

26 U.S.C.A. § 280E, I.R.C. § 280E

§ 280E. Expenditures in connection with the illegal sale of drugs

Currentness

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

CREDIT(S)

(Added Pub.L. 97-248, Title III, § 351(a), Sept. 3, 1982, 96 Stat. 640.)

26 U.S.C.A. § 280E, 26 USCA § 280E
Current through P.L. 116-140.

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United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle A. Income Taxes (Refs & Annos)
Chapter 1. Normal Taxes and Surtaxes (Refs & Annos)
Subchapter E. Accounting Periods and Methods of Accounting
Part II. Methods of Accounting
Subpart A. Methods of Accounting in General

26 U.S.C.A. § 446, I.R.C. § 446

§ 446. General rule for methods of accounting

Currentness

(a) General rule.--Taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

(b) Exceptions.--If no method of accounting has been regularly used by the taxpayer, or if the method used does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income.

(c) Permissible methods.--Subject to the provisions of subsections (a) and (b), a taxpayer may compute taxable income under any of the following methods of accounting--

(1) the cash receipts and disbursements method;

(2) an accrual method;

(3) any other method permitted by this chapter; or

(4) any combination of the foregoing methods permitted under regulations prescribed by the Secretary.

(d) Taxpayer engaged in more than one business.--A taxpayer engaged in more than one trade or business may, in computing taxable income, use a different method of accounting for each trade or business.

(e) Requirement respecting change of accounting method.--Except as otherwise expressly provided in this chapter, a taxpayer who changes the method of accounting on the basis of which he regularly computes his income in keeping his books shall, before computing his taxable income under the new method, secure the consent of the Secretary.

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(f) Failure to request change of method of accounting.--If the taxpayer does not file with the Secretary a request to change the method of accounting, the absence of the consent of the Secretary to a change in the method of accounting shall not be taken into account--

(1) to prevent the imposition of any penalty, or the addition of any amount to tax, under this title, or

(2) to diminish the amount of such penalty or addition to tax.

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 151; Pub.L. 94-455, Title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub.L. 98-369, Div. A, Title I, § 161(a), July 18, 1984, 98 Stat. 696.)

26 U.S.C.A. § 446, 26 USCA § 446
Current through P.L. 116-140.

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United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle A. Income Taxes (Refs & Annos)
Chapter 1. Normal Taxes and Surtaxes (Refs & Annos)
Subchapter E. Accounting Periods and Methods of Accounting
Part II. Methods of Accounting
Subpart D. Inventories

26 U.S.C.A. § 471, I.R.C. § 471

§ 471. General rule for inventories

Effective: December 22, 2017
Currentness

(a) General rule.--Whenever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(b) Estimates of inventory shrinkage permitted.--A method of determining inventories shall not be treated as failing to clearly reflect income solely because it utilizes estimates of inventory shrinkage that are confirmed by a physical count only after the last day of the taxable year if--

(1) the taxpayer normally does a physical count of inventories at each location on a regular and consistent basis, and

(2) the taxpayer makes proper adjustments to such inventories and to its estimating methods to the extent such estimates are greater than or less than the actual shrinkage.

(c) Exemption for certain small businesses.--

(1) In general.--In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year--

(A) subsection (a) shall not apply with respect to such taxpayer for such taxable year, and

(B) the taxpayer's method of accounting for inventory for such taxable year shall not be treated as failing to clearly reflect income if such method either--

(i) treats inventory as non-incidental materials and supplies, or

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(ii) conforms to such taxpayer's method of accounting reflected in an applicable financial statement of the taxpayer with respect to such taxable year or, if the taxpayer does not have any applicable financial statement with respect to such taxable year, the books and records of the taxpayer prepared in accordance with the taxpayer's accounting procedures.

(2) Applicable financial statement.--For purposes of this subsection, the term "applicable financial statement" has the meaning given the term in section 451(b)(3).

(3) Application of gross receipts test to individuals, etc.--In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

(4) Coordination with section 481.--Any change in method of accounting made pursuant to this subsection shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.

(d) Cross reference.--

For rules relating to capitalization of direct and indirect costs of property, see section 263A.

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 159; Pub.L. 94-455, Title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub.L. 99-514, Title VIII, § 803(b)(4), Oct. 22, 1986, 100 Stat. 2356; Pub.L. 105-34, Title IX, § 961(a), Aug. 5, 1997, 111 Stat. 891; Pub.L. 115-97, Title I, § 13102(c), Dec. 22, 2017, 131 Stat. 2103.)

26 U.S.C.A. § 471, 26 USCA § 471
Current through P.L. 116-140.

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United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle F. Procedure and Administration (Refs & Annos)
Chapter 63. Assessment
Subchapter B. Deficiency Procedures in the Case of Income, Estate, Gift, and Certain Excise Taxes (Refs & Annos)

26 U.S.C.A. § 6213, I.R.C. § 6213

§ 6213. Restrictions applicable to deficiencies; petition to Tax Court

Effective: March 27, 2020
Currentness

(a) Time for filing petition and restriction on assessment.--Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in section 6851, 6852, or 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A, or B, chapter 41, 42, 43, or 44 and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421(a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court, including the Tax Court, and a refund may be ordered by such court of any amount collected within the period during which the Secretary is prohibited from collecting by levy or through a proceeding in court under the provisions of this subsection. The Tax Court shall have no jurisdiction to enjoin any action or proceeding or order any refund under this subsection unless a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition. Any petition filed with the Tax Court on or before the last date specified for filing such petition by the Secretary in the notice of deficiency shall be treated as timely filed.

(b) Exceptions to restrictions on assessment.--

(1) Assessments arising out of mathematical or clerical errors.--If the taxpayer is notified that, on account of a mathematical or clerical error appearing on the return, an amount of tax in excess of that shown on the return is due, and that an assessment of the tax has been or will be made on the basis of what would have been the correct amount of tax but for the mathematical or clerical error, such notice shall not be considered as a notice of deficiency for the purposes of subsection (a) (prohibiting assessment and collection until notice of the deficiency has been mailed), or of section 6212(c)(1) (restricting further deficiency letters), or of section 6512(a) (prohibiting credits or refunds after petition to the Tax Court), and the taxpayer shall have no right to file a petition with the Tax Court based on such notice, nor shall such assessment or collection be prohibited by the provisions of subsection (a) of this section. Each notice under this paragraph shall set forth the error alleged and an explanation thereof.

(2) Abatement of assessment of mathematical or clerical errors.--

(A) Request for abatement.--Notwithstanding section 6404(b), a taxpayer may file with the Secretary within 60 days after notice is sent under paragraph (1) a request for an abatement of any assessment specified in such notice, and upon receipt of such request, the Secretary shall abate the assessment. Any reassessment of the tax with respect to which an abatement is made under this subparagraph shall be subject to the deficiency procedures prescribed by this subchapter.

(B) Stay of collection.--In the case of any assessment referred to in paragraph (1), notwithstanding paragraph (1), no levy or proceeding in court for the collection of such assessment shall be made, begun, or prosecuted during the period in which such assessment may be abated under this paragraph.

(3) Assessments arising out of tentative carryback or refund adjustments.--If the Secretary determines that the amount applied, credited, or refunded under section 6411 is in excess of the overassessment attributable to the carryback or the amount described in section 1341(b)(1) with respect to which such amount was applied, credited, or refunded, he may assess without regard to the provisions of paragraph (2) the amount of the excess as a deficiency as if it were due to a mathematical or clerical error appearing on the return.

(4) Assessment of amount paid.--Any amount paid as a tax or in respect of a tax may be assessed upon the receipt of such payment notwithstanding the provisions of subsection (a). In any case where such amount is paid after the mailing of a notice of deficiency under section 6212, such payment shall not deprive the Tax Court of jurisdiction over such deficiency determined under section 6211 without regard to such assessment.

(5) Certain orders of criminal restitution.--If the taxpayer is notified that an assessment has been or will be made pursuant to section 6201(a)(4)--

(A) such notice shall not be considered as a notice of deficiency for the purposes of subsection (a) (prohibiting assessment and collection until notice of the deficiency has been mailed), section 6212(c)(1) (restricting further deficiency letters), or section 6512(a) (prohibiting credits or refunds after petition to the Tax Court), and

(B) subsection (a) shall not apply with respect to the amount of such assessment.

(c) Failure to file petition.--If the taxpayer does not file a petition with the Tax Court within the time prescribed in subsection (a), the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the Secretary.

(d) Waiver of restrictions.--The taxpayer shall at any time (whether or not a notice of deficiency has been issued) have the right, by a signed notice in writing filed with the Secretary, to waive the restrictions provided in subsection (a) on the assessment and collection of the whole or any part of the deficiency.

(e) Suspension of filing period for certain excise taxes.--The running of the time prescribed by subsection (a) for filing a petition in the Tax Court with respect to the taxes imposed by section 4941 (relating to taxes on self-dealing), 4942 (relating to taxes on failure to distribute income), 4943 (relating to taxes on excess business holdings), 4944 (relating to investments which jeopardize charitable purpose), 4945 (relating to taxes on taxable expenditures), 4951 (relating to taxes on self-dealing),

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or 4952 (relating to taxes on taxable expenditures), 4955 (relating to taxes on political expenditures), 4958 (relating to private excess benefit), 4971 (relating to excise taxes on failure to meet minimum funding standard), 4975 (relating to excise taxes on prohibited transactions) shall be suspended for any period during which the Secretary has extended the time allowed for making correction under section 4963(e).

(f) Coordination with title 11.--

(1) Suspension of running of period for filing petition in title 11 cases.--In any case under title 11 of the United States Code, the running of the time prescribed by subsection (a) for filing a petition in the Tax Court with respect to any deficiency shall be suspended for the period during which the debtor is prohibited by reason of such case from filing a petition in the Tax Court with respect to such deficiency, and for 60 days thereafter.

(2) Certain action not taken into account.--For purposes of the second and third sentences of subsection (a), the filing of a proof of claim or request for payment (or the taking of any other action) in a case under title 11 of the United States Code shall not be treated as action prohibited by such second sentence.

(g) Definitions.--For purposes of this section--

(1) Return.--The term "return" includes any return, statement, schedule, or list, and any amendment or supplement thereto, filed with respect to any tax imposed by subtitle A or B, or chapter 41, 42, 43, or 44.

(2) Mathematical or clerical error.--The term "mathematical or clerical error" means--

(A) an error in addition, subtraction, multiplication, or division shown on any return,

(B) an incorrect use of any table provided by the Internal Revenue Service with respect to any return if such incorrect use is apparent from the existence of other information on the return,

(C) an entry on a return of an item which is inconsistent with another entry of the same or another item on such return,

(D) an omission of information which is required to be supplied on the return to substantiate an entry on the return,

(E) an entry on a return of a deduction or credit in an amount which exceeds a statutory limit imposed by subtitle A or B, or chapter 41, 42, 43, or 44, if such limit is expressed--

(i) as a specified monetary amount, or

(ii) as a percentage, ratio, or fraction,

and if the items entering into the application of such limit appear on such return,

(F) an omission of a correct taxpayer identification number required under section 32 (relating to the earned income credit) to be included on a return,

(G) an entry on a return claiming the credit under section 32 with respect to net earnings from self-employment described in section 32(c)(2)(A) to the extent the tax imposed by section 1401 (relating to self-employment tax) on such net earnings has not been paid,

(H) an omission of a correct TIN required under section 21 (relating to expenses for household and dependent care services necessary for gainful employment) or section 151 (relating to allowance of deductions for personal exemptions),

(I) an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return,

(J) an omission of a correct TIN required under section 25A(g)(1) (relating to higher education tuition and related expenses) to be included on a return,

(K) an omission of information required by section 32(k)(2) (relating to taxpayers making improper prior claims of earned income credit) or an entry on the return claiming the credit under section 32 for a taxable year for which the credit is disallowed under subsection (k)(1) thereof,

(L) the inclusion on a return of a TIN required to be included on the return under section 21, 24, 32, or 6428 if--

(i) such TIN is of an individual whose age affects the amount of the credit under such section, and

(ii) the computation of the credit on the return reflects the treatment of such individual as being of an age different from the individual's age based on such TIN,

(M) the entry on the return claiming the credit under section 32 with respect to a child if, according to the Federal Case Registry of Child Support Orders established under section 453(h) of the Social Security Act, the taxpayer is a noncustodial parent of such child,

(N) an omission of any increase required under section 36(f) with respect to the recapture of a credit allowed under section 36,

(O) the inclusion on a return of an individual taxpayer identification number issued under section 6109(i) which has expired, been revoked by the Secretary, or is otherwise invalid,

(P) an omission of information required by section 24(g)(2) or an entry on the return claiming the credit under section 24 for a taxable year for which the credit is disallowed under subsection (g)(1) thereof, and

(Q) an omission of information required by section 25A(b)(4)(B) or an entry on the return claiming the American Opportunity Tax Credit for a taxable year for which such credit is disallowed under section 25A(b)(4)(A).

A taxpayer shall be treated as having omitted a correct TIN for purposes of the preceding sentence if information provided by the taxpayer on the return with respect to the individual whose TIN was provided differs from the information the Secretary obtains from the person issuing the TIN.

(h) Cross references.--

(1) For assessment as if a mathematical error on the return, in the case of erroneous claims for income tax prepayment credits, see section 6201(a)(3).

(2) For assessments without regard to restrictions imposed by this section in the case of--

(A) Recovery of foreign income taxes, see section 905(c).

(B) Recovery of foreign estate tax, see section 2016.

(3) For provisions relating to application of this subchapter in the case of certain partnership items, etc., see section 6230(a).

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 771; Pub.L. 89-44, Title VIII, § 809(d)(4)(B), June 21, 1965, 79 Stat. 168; Pub.L. 91-172, Title I, § 101(f)(3), (j)(42), Dec. 30, 1969, 83 Stat. 524, 530; Pub.L. 93-406, Title II, § 1016(a)(11), Sept. 2, 1974, 88 Stat. 930; Pub.L. 94-455, Title XII, §§ 1204(c)(6), 1206(a) to (c)(1), Title XIII, § 1307(d)(2)(F)(iii), Title XVI, § 1605(b)(6), Title XIX, §§ 1906(a)(15), (b)(13)(A), Oct. 4, 1976, 90 Stat. 1698, 1703, 1704, 1728, 1755, 1825, 1834; Pub.L. 95-227, § 4(d)(1), (2), Feb. 10, 1978, 92 Stat. 23; Pub.L. 95-600, Title V, § 504(b)(2), Nov. 6, 1978, 92 Stat. 2881; Pub.L. 96-223, Title I, § 101(f)(1)(D), (E), Apr. 2, 1980, 94 Stat. 252; Pub.L. 96-589, § 6(b)(1), Dec. 24, 1980, 94 Stat. 3407; Pub.L. 96-596, § 2(a)(4)(C), Dec. 24, 1980, 94 Stat. 3472; Pub.L. 97-248, Title IV, § 402(c)(2), Sept. 3, 1982, 96 Stat. 667; Pub.L. 98-369, Div. A, Title III, § 305(b)(4), Title IV, § 474(r)(34), July 18, 1984, 98 Stat. 784, 845; Pub.L. 99-514, Title XVIII, § 1875(d)(2)(B)(i), Oct. 22, 1986, 100 Stat. 2896; Pub.L. 100-203, Title X, §§ 10712(c)(1), 10713(b)(2)(D), Dec. 22, 1987, 101 Stat. 1330-467, 1330-470; Pub.L. 100-418, Title I, § 1941(b)(2)(B)(iv), (v), Aug. 23, 1988, 102 Stat. 1323; Pub.L. 100-647, Title I, § 1015(r)(3), Title VI, § 6243(a), Nov. 10, 1988, 102 Stat. 3573, 3749; Pub.L. 101-239, Title VII, § 7811(k)(1), Dec. 19, 1989, 103 Stat. 2412; Pub.L. 104-168, Title XIII, § 1311(c)(3), July 30, 1996, 110 Stat. 1478; Pub.L. 104-188, Title I, § 1615(c), Aug. 20, 1996, 110 Stat. 1853; Pub.L. 104-193, Title IV, § 451(c), Aug. 22, 1996, 110 Stat. 2277; Pub.L. 105-34, Title I, § 101(d)(2), Title II, § 201(b), Title X, § 1085(a)(3), Aug. 5, 1997, 111 Stat. 799, 803, 956; Pub.L. 105-206, Title III, §§ 3463(b), 3464(a), Title VI, § 6010(p)(3), July 22, 1998, 112 Stat. 767, 817; Pub.L. 105-277, Div. J, Title III, § 3003(a), (b), Oct. 21, 1998, 112 Stat. 2681-905; Pub.L. 107-16, Title III, § 303(g), June 7, 2001, 115 Stat. 56; Pub.L. 110-185, Title I, § 101(b)(2), Feb. 13, 2008, 122 Stat. 616; Pub.L. 111-5, Div. B, Title I, § 1001(d), Feb. 17, 2009, 123 Stat. 312; Pub.L. 111-92, §§ 11(h), 12(d), Nov. 6, 2009, 123 Stat. 2991, 2992; Pub.L. 111-237, § 3(b)(1), Aug. 16, 2010, 124 Stat. 2498; Pub.L. 113-295, Div. A, Title II, §§ 214(a), 221(a)(4), (5)(C), (112)(C), Dec. 19, 2014, 128 Stat. 4034, 4037, 4038, 4054; Pub.L. 114-113, Div. Q, Title II, §§ 203(e), 208(b), Dec. 18, 2015, 129 Stat. 3080, 3084; Pub.L. 115-141, Div. U, Title I, § 101(l)(18), Title IV, § 401(a)(277), (278), Mar. 23, 2018, 132 Stat. 1165, 1197; Pub.L. 116-136, Div. A, Title II, § 2201(b)(2), Mar. 27, 2020, 134 Stat. 337.)

26 U.S.C.A. § 6213, 26 USCA § 6213
Current through P.L. 116-140.

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Proposed Legislation

United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle F. Procedure and Administration (Refs & Annos)
Chapter 68. Additions to the Tax, Additional Amounts, and Assessable Penalties
Subchapter A. Additions to the Tax and Additional Amounts
Part II. Accuracy-Related and Fraud Penalties

26 U.S.C.A. § 6662, I.R.C. § 6662

§ 6662. Imposition of accuracy-related penalty on underpayments

Currentness

(a) Imposition of penalty.--If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

(b) Portion of underpayment to which section applies.--This section shall apply to the portion of any underpayment which is attributable to 1 or more of the following:

(1) Negligence or disregard of rules or regulations.

(2) Any substantial understatement of income tax.

(3) Any substantial valuation misstatement under chapter 1.

(4) Any substantial overstatement of pension liabilities.

(5) Any substantial estate or gift tax valuation understatement.

(6) Any disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law.

(7) Any undisclosed foreign financial asset understatement.

(8) Any inconsistent estate basis.

This section shall not apply to any portion of an underpayment on which a penalty is imposed under section 6663. Except as provided in paragraph (1) or (2)(B) of section 6662A(e), this section shall not apply to the portion of any underpayment which is attributable to a reportable transaction understatement on which a penalty is imposed under section 6662A.

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(c) Negligence.--For purposes of this section, the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term "disregard" includes any careless, reckless, or intentional disregard.

(d) Substantial understatement of income tax.--

(1) Substantial understatement.--

(A) In general.--For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of--

(i) 10 percent of the tax required to be shown on the return for the taxable year, or

(ii) $5,000.

(B) Special rule for corporations.--In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the lesser of--

(i) 10 percent of the tax required to be shown on the return for the taxable year (or, if greater, $10,000), or

(ii) $10,000,000.

(C) Special rule for taxpayers claiming section 199A deduction.--In the case of any taxpayer who claims any deduction allowed under section 199A for the taxable year, subparagraph (A) shall be applied by substituting "5 percent" for "10 percent".

(2) Understatement.--

(A) In general.--For purposes of paragraph (1), the term "understatement" means the excess of--

(i) the amount of the tax required to be shown on the return for the taxable year, over

(ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).

The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies.

(B) Reduction for understatement due to position of taxpayer or disclosed item.--The amount of the understatement under subparagraph (A) shall be reduced by that portion of the understatement which is attributable to--

(i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or

(ii) any item if--

(I) the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return, and

(II) there is a reasonable basis for the tax treatment of such item by the taxpayer.

For purposes of clause (ii)(II), in no event shall a corporation be treated as having a reasonable basis for its tax treatment of an item attributable to a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation.

(C) Reduction not to apply to tax shelters.--

(i) In general.--Subparagraph (B) shall not apply to any item attributable to a tax shelter.

(ii) Tax shelter.--For purposes of clause (i), the term "tax shelter" means--

(I) a partnership or other entity,

(II) any investment plan or arrangement, or

(III) any other plan or arrangement,

if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

(3) Secretarial list.--The Secretary may prescribe a list of positions which the Secretary believes do not meet 1 or more of the standards specified in paragraph (2)(B)(i), section 6664(d)(3), and section 6694(a)(1). Such list (and any revisions thereof) shall be published in the Federal Register or the Internal Revenue Bulletin.

(e) Substantial valuation misstatement under chapter 1.--

(1) In general.--For purposes of this section, there is a substantial valuation misstatement under chapter 1 if--

(A) the value of any property (or the adjusted basis of any property) claimed on any return of tax imposed by chapter 1 is 150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be), or

(B)(i) the price for any property or services (or for the use of property) claimed on any such return in connection with any transaction between persons described in section 482 is 200 percent or more (or 50 percent or less) of the amount determined under section 482 to be the correct amount of such price, or

(ii) the net section 482 transfer price adjustment for the taxable year exceeds the lesser of $5,000,000 or 10 percent of the taxpayer's gross receipts.

(2) Limitation.--No penalty shall be imposed by reason of subsection (b)(3) unless the portion of the underpayment for the taxable year attributable to substantial valuation misstatements under chapter 1 exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company (as defined in section 542)).

(3) Net section 482 transfer price adjustment.--For purposes of this subsection--

(A) In general.--The term "net section 482 transfer price adjustment" means, with respect to any taxable year, the net increase in taxable income for the taxable year (determined without regard to any amount carried to such taxable year from another taxable year) resulting from adjustments under section 482 in the price for any property or services (or for the use of property).

(B) Certain adjustments excluded in determining threshold.--For purposes of determining whether the threshold requirements of paragraph (1)(B)(ii) are met, the following shall be excluded:

(i) Any portion of the net increase in taxable income referred to in subparagraph (A) which is attributable to any redetermination of a price if--

(I) it is established that the taxpayer determined such price in accordance with a specific pricing method set forth in the regulations prescribed under section 482 and that the taxpayer's use of such method was reasonable,

(II) the taxpayer has documentation (which was in existence as of the time of filing the return) which sets forth the determination of such price in accordance with such a method and which establishes that the use of such method was reasonable, and

(III) the taxpayer provides such documentation to the Secretary within 30 days of a request for such documentation.

(ii) Any portion of the net increase in taxable income referred to in subparagraph (A) which is attributable to a redetermination of price where such price was not determined in accordance with such a specific pricing method if--

(I) the taxpayer establishes that none of such pricing methods was likely to result in a price that would clearly reflect income, the taxpayer used another pricing method to determine such price, and such other pricing method was likely to result in a price that would clearly reflect income,

(II) the taxpayer has documentation (which was in existence as of the time of filing the return) which sets forth the determination of such price in accordance with such other method and which establishes that the requirements of subclause (I) were satisfied, and

(III) the taxpayer provides such documentation to the Secretary within 30 days of request for such documentation.

(iii) Any portion of such net increase which is attributable to any transaction solely between foreign corporations unless, in the case of any such corporations, the treatment of such transaction affects the determination of income from sources within the United States or taxable income effectively connected with the conduct of a trade or business within the United States.

(C) Special rule.--If the regular tax (as defined in section 55(c)) imposed by chapter 1 on the taxpayer is determined by reference to an amount other than taxable income, such amount shall be treated as the taxable income of such taxpayer for purposes of this paragraph.

(D) Coordination with reasonable cause exception.--For purposes of section 6664(c) the taxpayer shall not be treated as having reasonable cause for any portion of an underpayment attributable to a net section 482 transfer price adjustment unless such taxpayer meets the requirements of clause (i), (ii), or (iii) of subparagraph (B) with respect to such portion.

(f) Substantial overstatement of pension liabilities.--

(1) In general.--For purposes of this section, there is a substantial overstatement of pension liabilities if the actuarial determination of the liabilities taken into account for purposes of computing the deduction under paragraph (1) or (2) of section 404(a) is 200 percent or more of the amount determined to be the correct amount of such liabilities.

(2) Limitation.--No penalty shall be imposed by reason of subsection (b)(4) unless the portion of the underpayment for the taxable year attributable to substantial overstatements of pension liabilities exceeds $1,000.

(g) Substantial estate or gift tax valuation understatement.--

(1) In general.--For purposes of this section, there is a substantial estate or gift tax valuation understatement if the value of any property claimed on any return of tax imposed by subtitle B is 65 percent or less of the amount determined to be the correct amount of such valuation.

(2) Limitation.--No penalty shall be imposed by reason of subsection (b)(5) unless the portion of the underpayment attributable to substantial estate or gift tax valuation understatements for the taxable period (or, in the case of the tax imposed by chapter 11, with respect to the estate of the decedent) exceeds $5,000.

(h) Increase in penalty in case of gross valuation misstatements.--

(1) In general.--To the extent that a portion of the underpayment to which this section applies is attributable to one or more gross valuation misstatements, subsection (a) shall be applied with respect to such portion by substituting “40 percent” for “20 percent”.

(2) Gross valuation misstatements.--The term “gross valuation misstatements” means--

(A) any substantial valuation misstatement under chapter 1 as determined under subsection (e) by substituting--

(i) in paragraph (1)(A), “200 percent” for “150 percent”,

(ii) in paragraph (1)(B)(i)--

(I) “400 percent” for “200 percent”, and

(II) “25 percent” for “50 percent”, and

(iii) in paragraph (1)(B)(ii)--

(I) “$20,000,000” for “$5,000,000”, and

(II) “20 percent” for “10 percent”.

(B) any substantial overstatement of pension liabilities as determined under subsection (f) by substituting “400 percent” for “200 percent”, and

(C) any substantial estate or gift tax valuation understatement as determined under subsection (g) by substituting “40 percent” for “65 percent”.

(i) Increase in penalty in case of nondisclosed noneconomic substance transactions.--

(1) In general.--In the case of any portion of an underpayment which is attributable to one or more nondisclosed noneconomic substance transactions, subsection (a) shall be applied with respect to such portion by substituting “40 percent” for “20 percent”.

(2) Nondisclosed noneconomic substance transactions.--For purposes of this subsection, the term "nondisclosed noneconomic substance transaction" means any portion of a transaction described in subsection (b)(6) with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return nor in a statement attached to the return.

(3) Special rule for amended returns.--In no event shall any amendment or supplement to a return of tax be taken into account for purposes of this subsection if the amendment or supplement is filed after the earlier of the date the taxpayer is first contacted by the Secretary regarding the examination of the return or such other date as is specified by the Secretary.

(j) Undisclosed foreign financial asset understatement.--

(1) In general.--For purposes of this section, the term "undisclosed foreign financial asset understatement" means, for any taxable year, the portion of the understatement for such taxable year which is attributable to any transaction involving an undisclosed foreign financial asset.

(2) Undisclosed foreign financial asset.--For purposes of this subsection, the term "undisclosed foreign financial asset" means, with respect to any taxable year, any asset with respect to which information was required to be provided under section 6038, 6038B, 6038D, 6046A, or 6048 for such taxable year but was not provided by the taxpayer as required under the provisions of those sections.

(3) Increase in penalty for undisclosed foreign financial asset understatements.--In the case of any portion of an underpayment which is attributable to any undisclosed foreign financial asset understatement, subsection (a) shall be applied with respect to such portion by substituting "40 percent" for "20 percent".

(k) Inconsistent estate basis reporting.--For purposes of this section, the term "inconsistent estate basis" means any portion of an underpayment attributable to the failure to comply with section 1014(f).

CREDIT(S)

(Added Pub.L. 101-239, Title VII, § 7721(a), Dec. 19, 1989, 103 Stat. 2395; amended Pub.L. 101-508, Title XI, § 11312(a), (b), Nov. 5, 1990, 104 Stat. 1388-454, 1388-455; Pub.L. 103-66, Title XIII, §§ 13236(a) to (d), 13251(a), Aug. 10, 1993, 107 Stat. 505, 506, 531; Pub.L. 103-465, Title VII, § 744(a), (b), Dec. 8, 1994, 108 Stat. 5011; Pub.L. 105-34, Title X, § 1028(c), Aug. 5, 1997, 111 Stat. 928; Pub.L. 108-357, Title VIII, §§ 812(b), (d), (e)(1), 819(a), (b), Oct. 22, 2004, 118 Stat. 1578, 1580, 1584; Pub.L. 109-135, Title IV, §§ 403(x)(1), 412(aaa), Dec. 21, 2005, 119 Stat. 2629, 2641; Pub.L. 109-280, Title XII, § 1219(a)(1), (2), Aug. 17, 2006, 120 Stat. 1083; Pub.L. 111-147, Title V, § 512(a), Mar. 18, 2010, 124 Stat. 110; Pub.L. 111-152, Title I, § 1409(b)(1), (2), Mar. 30, 2010, 124 Stat. 1068, 1069; Pub.L. 113-295, Div. A, Title II, § 208(a), Dec. 19, 2014, 128 Stat. 4028; Pub.L. 114-41, Title II, § 2004(c), July 31, 2015, 129 Stat. 456; Pub.L. 115-97, Title I, § 11011(c), Dec. 22, 2017, 131 Stat. 2070; Pub.L. 115-141, Div. T, § 101(a)(2)(A), Div. U, Title I, § 104(a), Title IV, § 401(a)(303), (304), Mar. 23, 2018, 132 Stat. 1155, 1170, 1199.)

26 U.S.C.A. § 6662, 26 USCA § 6662
Current through P.L. 116-140.

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United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle F. Procedure and Administration (Refs & Annos)
Chapter 76. Judicial Proceedings
Subchapter D. Court Review of Tax Court Decisions (Refs & Annos)

26 U.S.C.A. § 7481, I.R.C. § 7481

§ 7481. Date when Tax Court decision becomes final

Effective: August 5, 1997
Currentness

(a) Reviewable decisions.--Except as provided in subsections (b), (c), and (d), the decision of the Tax Court shall become final--

(1) Timely notice of appeal not filed.--Upon the expiration of the time allowed for filing a notice of appeal, if no such notice has been duly filed within such time; or

(2) Decision affirmed or appeal dismissed.--

(A) Petition for certiorari not filed on time.--Upon the expiration of the time allowed for filing a petition for certiorari, if the decision of the Tax Court has been affirmed or the appeal dismissed by the United States Court of Appeals and no petition for certiorari has been duly filed; or

(B) Petition for certiorari denied.--Upon the denial of a petition for certiorari, if the decision of the Tax Court has been affirmed or the appeal dismissed by the United States Court of Appeals; or

(C) After mandate of Supreme Court.--Upon the expiration of 30 days from the date of issuance of the mandate of the Supreme Court, if such Court directs that the decision of the Tax Court be affirmed or the appeal dismissed.

(3) Decision modified or reversed.--

(A) Upon mandate of Supreme Court.--If the Supreme Court directs that the decision of the Tax Court be modified or reversed, the decision of the Tax Court rendered in accordance with the mandate of the Supreme Court shall become final upon the expiration of 30 days from the time it was rendered, unless within such 30 days either the Secretary or the taxpayer has instituted proceedings to have such decision corrected to accord with the mandate, in which event the decision of the Tax Court shall become final when so corrected.

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(B) Upon mandate of the Court of Appeals.--If the decision of the Tax Court is modified or reversed by the United States Court of Appeals, and if--

(i) the time allowed for filing a petition for certiorari has expired and no such petition has been duly filed, or

(ii) the petition for certiorari has been denied, or

(iii) the decision of the United States Court of Appeals has been affirmed by the Supreme Court, then the decision of the Tax Court rendered in accordance with the mandate of the United States Court of Appeals shall become final on the expiration of 30 days from the time such decision of the Tax Court was rendered, unless within such 30 days either the Secretary or the taxpayer has instituted proceedings to have such decision corrected so that it will accord with the mandate, in which event the decision of the Tax Court shall become final when so corrected.

(4) Rehearing.--If the Supreme Court orders a rehearing; or if the case is remanded by the United States Court of Appeals to the Tax Court for a rehearing, and if--

(A) the time allowed for filing a petition for certiorari has expired and no such petition has been duly filed, or

(B) the petition for certiorari has been denied, or

(C) the decision of the United States Court of Appeals has been affirmed by the Supreme Court,

then the decision of the Tax Court rendered upon such rehearing shall become final in the same manner as though no prior decision of the Tax Court has been rendered.

(5) Definition of "mandate".--As used in this section, the term "mandate", in case a mandate has been recalled prior to the expiration of 30 days from the date of issuance thereof, means the final mandate.

(b) Nonreviewable decisions.--The decision of the Tax Court in a proceeding conducted under section 7436(c) or 7463 shall become final upon the expiration of 90 days after the decision is entered.

(c) Jurisdiction over interest determinations.--

(1) In general.--Notwithstanding subsection (a), if, within 1 year after the date the decision of the Tax Court becomes final under subsection (a) in a case to which this subsection applies, the taxpayer files a motion in the Tax Court for a redetermination of the amount of interest involved, then the Tax Court may reopen the case solely to determine whether the taxpayer has made an overpayment of such interest or the Secretary has made an underpayment of such interest and the amount thereof.

(2) Cases to which this subsection applies.--This subsection shall apply where--

(A)(i) an assessment has been made by the Secretary under section 6215 which includes interest as imposed by this title, and

(ii) the taxpayer has paid the entire amount of the deficiency plus interest claimed by the Secretary, and

(B) the Tax Court finds under section 6512(b) that the taxpayer has made an overpayment.

(3) Special rules.--If the Tax Court determines under this subsection that the taxpayer has made an overpayment of interest or that the Secretary has made an underpayment of interest, then that determination shall be treated under section 6512(b)(1) as a determination of an overpayment of tax. An order of the Tax Court redetermining interest, when entered upon the records of the court, shall be reviewable in the same manner as a decision of the Tax Court.

(d) Decisions relating to estate tax extended under section 6166.--If with respect to a decedent's estate subject to a decision of the Tax Court--

(1) the time for payment of an amount of tax imposed by chapter 11 is extended under section 6166, and

(2) there is treated as an administrative expense under section 2053 either--

(A) any amount of interest which a decedent's estate pays on any portion of the tax imposed by section 2001 on such estate for which the time of payment is extended under section 6166, or

(B) interest on any estate, succession, legacy, or inheritance tax imposed by a State on such estate during the period of the extension of time for payment under section 6166,

then, upon a motion by the petitioner in such case in which such time for payment of tax has been extended under section 6166, the Tax Court may reopen the case solely to modify the Court's decision to reflect such estate's entitlement to a deduction for such administration expenses under section 2053 and may hold further trial solely with respect to the claim for such deduction if, within the discretion of the Tax Court, such a hearing is deemed necessary. An order of the Tax Court disposing of a motion under this subsection shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order.

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 889; Pub.L. 91-172, Title IX, § 960(h)(1), Dec. 30, 1969, 83 Stat. 734; Pub.L. 94-455, Title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub.L. 100-647, Title VI, §§ 6246(a), (b)(2), 6247(a), (b)(2), Nov. 10, 1988, 102 Stat. 3751, 3752; Pub.L. 105-34, Title XIV, §§ 1452(a), 1454(b)(3), Aug. 5, 1997, 111 Stat. 1054, 1057.)

26 U.S.C.A. § 7481, 26 USCA § 7481
Current through P.L. 116-140.

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United States Code Annotated
Title 26. Internal Revenue Code (Refs & Annos)
Subtitle F. Procedure and Administration (Refs & Annos)
Chapter 76. Judicial Proceedings
Subchapter D. Court Review of Tax Court Decisions (Refs & Annos)

26 U.S.C.A. § 7482, I.R.C. §7482

§ 7482. Courts of review

Effective: January 1, 2018
Currentness

(a) Jurisdiction.--

(1) In general.--The United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

(2) Interlocutory orders.--

(A) In general.--When any judge of the Tax Court includes in an interlocutory order a statement that a controlling question of law is involved with respect to which there is a substantial ground for difference of opinion and that an immediate appeal from that order may materially advance the ultimate termination of the litigation, the United States Court of Appeals may, in its discretion, permit an appeal to be taken from such order, if application is made to it within 10 days after the entry of such order. Neither the application for nor the granting of an appeal under this paragraph shall stay proceedings in the Tax Court, unless a stay is ordered by a judge of the Tax Court or by the United States Court of Appeals which has jurisdiction of the appeal or a judge of that court.

(B) Order treated as Tax Court decision.--For purposes of subsections (b) and (c), an order described in this paragraph shall be treated as a decision of the Tax Court.

(C) Venue for review of subsequent proceedings.--If a United States Court of Appeals permits an appeal to be taken from an order described in subparagraph (A), except as provided in subsection (b)(2), any subsequent review of the decision of the Tax Court in the proceeding shall be made by such Court of Appeals.

(3) Certain orders entered under section 6213(a).--An order of the Tax Court which is entered under authority of section 6213(a) and which resolves a proceeding to restrain assessment or collection shall be treated as a decision of the Tax Court for purposes of this section and shall be subject to the same review by the United States Court of Appeals as a similar order of a district court.

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(b) Venue.--

(1) In general.--Except as otherwise provided in paragraphs (2) and (3), such decisions may be reviewed by the United States court of appeals for the circuit in which is located--

(A) in the case of a petitioner seeking redetermination of tax liability other than a corporation, the legal residence of the petitioner,

(B) in the case of a corporation seeking redetermination of tax liability, the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in any judicial circuit, then the office to which was made the return of the tax in respect of which the liability arises,

(C) in the case of a person seeking a declaratory decision under section 7476, the principal place of business, or principal office or agency of the employer,

(D) in the case of an organization seeking a declaratory decision under section 7428, the principal office or agency of the organization,

(E) in the case of a petition under section 6234, the principal place of business of the partnership,

(F) in the case of a petition under section 6015(e), the legal residence of the petitioner, or

(G) in the case of a petition under section 6320 or 6330--

(i) the legal residence of the petitioner if the petitioner is an individual, and

(ii) the principal place of business or principal office or agency if the petitioner is an entity other than an individual.

If for any reason no subparagraph of the preceding sentence applies, then such decisions may be reviewed by the Court of Appeals for the District of Columbia. For purposes of this paragraph, the legal residence, principal place of business, or principal office or agency referred to herein shall be determined as of the time the petition seeking redetermination of tax liability was filed with the Tax Court or as of the time the petition seeking a declaratory decision under section 7428 or 7476, or the petition under section 6234, was filed with the Tax Court.

(2) By agreement.--Notwithstanding the provisions of paragraph (1), such decisions may be reviewed by any United States Court of Appeals which may be designated by the Secretary and the taxpayer by stipulation in writing.

(3) Declaratory judgment actions relating to status of certain governmental obligations.--In the case of any decision of the Tax Court in a proceeding under section 7478, such decision may only be reviewed by the Court of Appeals for the District of Columbia.

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(c) Powers.--

(1) To affirm, modify, or reverse.--Upon such review, such courts shall have power to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court, with or without remanding the case for a rehearing, as justice may require.

(2) To make rules.--Rules for review of decisions of the Tax Court shall be those prescribed by the Supreme Court under section 2072 of title 28 of the United States Code.

(3) To require additional security.--Nothing in section 7483 shall be construed as relieving the petitioner from making or filing such undertakings as the court may require as a condition of or in connection with the review.

(4) To impose penalties.--The United States Court of Appeals and the Supreme Court shall have the power to require the taxpayer to pay to the United States a penalty in any case where the decision of the Tax Court is affirmed and it appears that the appeal was instituted or maintained primarily for delay or that the taxpayer's position in the appeal is frivolous or groundless.

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 890; Pub.L. 89-713, § 3(c), Nov. 2, 1966, 80 Stat. 1109; Pub.L. 91-172, Title IX, § 960(h)(2), Dec. 30, 1969, 83 Stat. 735; Pub.L. 93-406, Title II, § 1041(b)(3), Sept. 2, 1974, 88 Stat. 950; Pub.L. 94-455, Title X, § 1042(d)(2)(A), (B), Title XIII, § 1306(b)(4), (5), Title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1638, 1639, 1719, 1834; Pub.L. 95-600, Title III, § 336(c)(1), Nov. 6, 1978, 92 Stat. 2842; Pub.L. 97-164, Title I, § 154, Apr. 2, 1982, 96 Stat. 47; Pub.L. 97-248, Title IV, § 402(c)(15), Sept. 3, 1982, 96 Stat. 668; Pub.L. 98-369, Div. A, Title I, § 131(e)(2)(A), July 18, 1984, 98 Stat. 665; Pub.L. 99-514, Title XV, § 1558(a), (b), Title XVIII, §§ 1810(g)(2), 1899A(60), Oct. 22, 1986, 100 Stat. 2757, 2758, 2828, 2962; Pub.L. 100-647, Title VI, § 6243(b), Nov. 10, 1988, 102 Stat. 3750; Pub.L. 101-239, Title VII, § 7731(b), Dec. 19, 1989, 103 Stat. 2401; Pub.L. 105-34, Title XII, §§ 1222(b)(3), 1239(d), Aug. 5, 1997, 111 Stat. 1019, 1028; Pub.L. 114-74, Title XI, § 1101(f)(13), Nov. 2, 2015, 125 Stat. 638; Pub.L. 114-113, Div. Q, Title IV, § 423(a), Dec. 18, 2015, 129 Stat. 3123.)

26 U.S.C.A. § 7482, 26 USCA § 7482
Current through P.L. 116-140.

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Chapter 76. Judicial Proceedings
Subchapter D. Court Review of Tax Court Decisions (Refs & Annos)

26 U.S.C.A. § 7483, I.R.C. § 7483

§ 7483. Notice of appeal

Currentness

Review of a decision of the Tax Court shall be obtained by filing a notice of appeal with the clerk of the Tax Court within 90 days after the decision of the Tax Court is entered. If a timely notice of appeal is filed by one party, any other party may take an appeal by filing a notice of appeal within 120 days after the decision of the Tax Court is entered.

CREDIT(S)

(Aug. 16, 1954, c. 736, 68A Stat. 891; Pub.L. 91-172, Title IX, § 959(a), Dec. 30, 1969, 83 Stat. 734.)

26 U.S.C.A. § 7483, 26 USCA § 7483
Current through P.L. 116-140.

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INCOME TAX. Division of earnings of taxable years.

(e) Any distribution made during the first sixty days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the remainder of the taxable year shall be deemed to have been made from earnings or profits accumulated between the close of the preceding taxable year and the date of distribution, to the extent of such earnings or profits, and if the books of the corporation do not show the amount of such earnings or profits, the earnings or profits for the accounting period within which the distribution was made shall be deemed to have been accumulated ratably during such period.

Gain or loss.

BASIS FOR DETERMINING GAIN OR LOSS.

Basis on sales, etc., of property.

SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

Acquired before March 1, 1913.

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

Subsequently acquired.

(2) In the case of property acquired on or after that date, the cost thereof; or the inventory value, if the inventory is made in accordance with section 203.

On exchanges of property.

For reorganizations.

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or securities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

Gain when value of new, exceeds that of exchanged stocks, etc.

When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged.

Inventories.

INVENTORIES.

Use of, to determine income.

SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

Net losses.

NET LOSSES.

In regular business.

On sales of plants for war facilities, etc.

SEC. 204. (a) That as used in this section the term "net loss" refers only to net losses resulting from either (1) the operation of any business regularly carried on by the taxpayer, or (2) the bona fide sale by the taxpayer of plant, buildings, machinery, equipment or other facilities, constructed, installed or acquired by the taxpayer on or after April 6, 1917, for the production of articles contributing

INCOME TAX.

If other than similar property received.

and if in excess of such basis, shall be taxable to the extent of the excess; but when property is exchanged for property specified in paragraphs (1), (2), and (3) of subdivision (c) as received in exchange, together with money or other property of a readily realizable market value other than that specified in such paragraphs, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess.

Tax on installment payments.

(f) Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

INVENTORIES.

Inventories.

Use of, in determining incomes.

Sec. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

NET LOSSES.

Net losses.

In regular business.

Sec. 204. (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); and when so resulting means the excess of the deductions allowed by section 214 or 234, as the case may be, over the sum of the following: (1) the gross income of the taxpayer for the taxable year, (2) the amount by which the interest received free from taxation under this title exceeds so much of the interest paid or accrued within the taxable year on indebtedness as is not permitted to be deducted by paragraph (2) of subdivision (a) of section 214 or by paragraph (2) of subdivision (a) of section 234, (3) the amount by which the deductible losses not sustained in such trade or business exceed the taxable gains or profits not derived from such trade or business, (4) amounts received as dividends and allowed as a deduction under paragraph (6) of subdivision (a) of section 234, and (5) so much of the depletion deduction allowed with respect to any mine, oil or gas well as is based upon discovery value in lieu of cost.

Method of determining.

Post, pp. 239, 254.

Allowance to be deducted from succeeding taxable years.

(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

Partnership, estate or trust beneficiaries, and insurance companies included.

Post, pp. 261, 262.

(c) The benefit of this section shall be allowed to the members of a partnership and the beneficiaries of an estate or trust, and to insurance companies subject to the tax imposed by section 243 or 246, under regulations prescribed by the Commissioner with the approval of the Secretary.

Allowance for fiscal year ending in 1921.

(d) If it appears, upon the production of evidence satisfactory to the Commissioner, that a taxpayer having a fiscal year beginning in

U.S.C.A. Const. Amend. XVI

Amendment XVI. Income Tax

Currentness

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

U.S.C.A. Const. Amend. XVI, USCA CONST Amend. XVI
Current through P.L. 116-140.

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United States Code Annotated
Constitution of the United States
Annotated
Article I. The Congress

U.S.C.A. Const. Art. I § 2, cl. 3

Section 2, Clause 3. Apportionment of Representatives and Taxes

Currentness

[Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons.] The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. The Number of Representatives shall not exceed one for every thirty Thousand, but each State shall have at Least one Representative; and until such enumeration shall be made, the State of New Hampshire shall be entitled to chuse three, Massachusetts eight, Rhode-Island and Providence Plantations one, Connecticut five, New-York six, New Jersey four, Pennsylvania eight, Delaware one, Maryland six, Virginia ten, North Carolina five, South Carolina five, and Georgia three.

U.S.C.A. Const. Art. I § 2, cl. 3, USCA CONST Art. I § 2, cl. 3
Current through P.L. 116-140.

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United States Code Annotated
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Annotated
Article I. The Congress

U.S.C.A. Const. Art. I § 8, cl. 1

Section 8, Clause 1. Powers of Congress; Levy of Taxes for Common Defense and General Welfare; Uniformity of Taxation

Currentness

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

U.S.C.A. Const. Art. I § 8, cl. 1, USCA CONST Art. I § 8, cl. 1
Current through P.L. 116-140.

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United States Code Annotated
Constitution of the United States
Annotated
Article I. The Congress

U.S.C.A. Const. Art. I § 9, cl. 4

Section 9, Clause 4. Capitation and Other Direct Taxes

Currentness

No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

U.S.C.A. Const. Art. I § 9, cl. 4, USCA CONST Art. I § 9, cl. 4
Current through P.L. 116-140.

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Unconstitutional or PreemptedPrior Version Held Invalid Max Sobel Wholesale Liquors v. C. I. R., 9th Cir., Sep. 22, 1980

Code of Federal Regulations
Title 26. Internal Revenue
Chapter I. Internal Revenue Service, Department of the Treasury
Subchapter A. Income Tax
Part 1. Income Taxes (Refs & Annos)
Normal Taxes and Surtaxes
Computation of Taxable Income
Definition of Gross Income, Adjusted Gross Income, and Taxable Income

26 C.F.R. § 1.61–3, Treas. Reg. § 1.61–3

§ 1.61–3 Gross income derived from business.

Currentness

(a) In general. In a manufacturing, merchandising, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. Gross income is determined without subtraction of depletion allowances based on a percentage of income to the extent that it exceeds cost depletion which may be required to be included in the amount of inventoriable costs as provided in § 1.471–11 and without subtraction of selling expenses, losses or other items not ordinarily used in computing costs of goods sold or amounts which are of a type for which a deduction would be disallowed under section 162(c), (f), or (g) in the case of a business expense. The cost of goods sold should be determined in accordance with the method of accounting consistently used by the taxpayer. Thus, for example, an amount cannot be taken into account in the computation of cost of goods sold any earlier than the taxable year in which economic performance occurs with respect to the amount (see § 1.446–1(c)(1)(ii)).

(b) State contracts. The profit from a contract with a State or political subdivision thereof must be included in gross income. If warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the fair market value of such warrants should be returned as income. If, upon conversion of the warrants into cash, the contractor does not receive and cannot recover the full value of the warrants so returned, he may deduct any loss sustained from his gross income for the year in which the warrants are so converted. If, however, he realizes more than the value of the warrants so returned, he must include the excess in his gross income for the year in which realized.

Credits

[T.D. 6500, 25 FR 11402, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7207, 37 FR 20767, Oct. 5, 1972; T.D. 7285, 38 FR 26184, Sept. 19, 1973; T.D. 8408, 57 FR 12419, April 10, 1992]

Historical Treasury Decisions: T.D. 6272, Nov. 25, 1957; T.D. 7285, Sept. 14, 1973.

AUTHORITY: Section 1.901(j)–1 also issued under 26 U.S.C. 901(j)(4).; Section 1.987–12 is issued under 26 U.S.C. 987 and 989.; Section 1.7701(l)–4 also issued under 26 U.S.C. 7701(l) and 954(c)(6)(A).

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Notes of Decisions (40)

Current through May 14, 2020, 85 FR 29317.

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Code of Federal Regulations
Title 26. Internal Revenue
Chapter I. Internal Revenue Service, Department of the Treasury
Subchapter A. Income Tax
Part 1. Income Taxes (Refs & Annos)
Normal Taxes and Surtaxes
Computation of Taxable Income
Itemized Deductions for Individuals and Corporations

26 C.F.R. § 1.162–1, Treas. Reg. § 1.162–1

§ 1.162–1 Business expenses.

Currentness

(a) In general. Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than section 162. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. See paragraph (a) of § 1.161–3. Among the items included in business expenses are management expenses, commissions (but see section 263 and the regulations thereunder), labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see § 1.162–2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. No such item shall be included in business expenses, however, to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in determining the gain or loss basis of its plant, equipment, or other property. See section 1054 and the regulations thereunder. A deduction for an expense paid or incurred after December 30, 1969, which would otherwise be allowable under section 162 shall not be denied on the grounds that allowance of such deduction would frustrate a sharply defined public policy. See section 162(c), (f), and (g) and the regulations thereunder. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is deductible, even though such expenses exceed the gross income derived during the taxable year from such business. In the case of any sports program to which section 114 (relating to sports programs conducted for the American National Red Cross) applies, expenses described in section 114(a)(2) shall be allowable as deductions under section 162(a) only to the extent that such expenses exceed the amount excluded from gross income under section 114(a).

(b) Cross references. (1) For charitable contributions by individuals and corporations not deductible under section 162, see § 1.162–15.

(2) For items not deductible, see sections 261–276, inclusive, and the regulations thereunder.

(3) For research and experimental expenditures, see section 174 and regulations thereunder.

(4) For soil and water conservation expenditures, see section 175 and regulations thereunder.

(5) For expenditures attributable to grant or loan by United States for encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, see section 621 and regulations thereunder.

(6) For treatment of certain rental payments with respect to public utility property, see section 167(1) and § 1.167(1)–3.

(7) For limitations on the deductibility of miscellaneous itemized deductions, see section 67 and §§ 1.67–1T through 1.67–4T.

(8) For the timing of deductions with respect to notional principal contracts, see § 1.446–3.

Credits

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6690, 28 FR 12253, Nov. 19, 1963; T.D. 6996, 34 FR 835, Jan. 18, 1969; T.D. 7315, 39 FR 20203, June 7, 1974; T.D. 7345, 40 FR 7437, Feb. 20, 1975; T.D. 8189, 53 FR 9881, March 28, 1988; T.D. 8491, 58 FR 53128, Oct. 14, 1993]

Historical Treasury Decisions: T.D. 6291, April 3, 1958.

AUTHORITY: Section 1.901(j)–1 also issued under 26 U.S.C. 901(j)(4).; Section 1.987–12 is issued under 26 U.S.C. 987 and 989.; Section 1.7701(l)–4 also issued under 26 U.S.C. 7701(l) and 954(c)(6)(A).

Notes of Decisions (911)

Current through May 14, 2020, 85 FR 29317.

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Proposed Regulation

Code of Federal Regulations
Title 26. Internal Revenue
Chapter I. Internal Revenue Service, Department of the Treasury
Subchapter A. Income Tax
Part 1. Income Taxes (Refs & Annos)
Normal Taxes and Surtaxes
Deferred Compensation, Etc.
Methods of Accounting
Methods of Accounting in General

26 C.F.R. § 1.446–1, Treas. Reg. § 1.446–1

§ 1.446–1 General rule for methods of accounting.

Effective: August 31, 2011
Currentness

(a) General rule. (1) Section 446(a) provides that taxable income shall be computed under the method of accounting on the basis of which a taxpayer regularly computes his income in keeping his books. The term "method of accounting" includes not only the overall method of accounting of the taxpayer but also the accounting treatment of any item. Examples of such over-all methods are the cash receipts and disbursements method, an accrual method, combinations of such methods, and combinations of the foregoing with various methods provided for the accounting treatment of special items. These methods of accounting for special items include the accounting treatment prescribed for research and experimental expenditures, soil and water conservation expenditures, depreciation, net operating losses, etc. Except for deviations permitted or required by such special accounting treatment, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. For requirement respecting the adoption or change of accounting method, see section 446(e) and paragraph (e) of this section.

(2) It is recognized that no uniform method of accounting can be prescribed for all taxpayers. Each taxpayer shall adopt such forms and systems as are, in his judgment, best suited to his needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. A method of accounting which reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income, provided all items of gross income and expense are treated consistently from year to year.

(3) Items of gross income and expenditures which are elements in the computation of taxable income need not be in the form of cash. It is sufficient that such items can be valued in terms of money. For general rules relating to the taxable year for inclusion of income and for taking deductions, see sections 451 and 461, and the regulations thereunder.

(4) Each taxpayer is required to make a return of his taxable income for each taxable year and must maintain such accounting records as will enable him to file a correct return. See section 6001 and the regulations thereunder. Accounting records include the taxpayer's regular books of account and such other records and data as may be necessary to support the entries on his books of account and on his return, as for example, a reconciliation of any differences between such books and his return. The following are among the essential features that must be considered in maintaining such records:

(i) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, merchandise on hand (including finished goods, work in process, raw materials, and supplies) at the beginning and end of the year shall be taken into account in computing the taxable income of the year. (For rules relating to computation of inventories, see section 263A, 471, and 472 and the regulations thereunder.)

(ii) Expenditures made during the year shall be properly classified as between capital and expense. For example, expenditures for such items as plant and equipment, which have a useful life extending substantially beyond the taxable year, shall be charged to a capital account and not to an expense account.

(iii) In any case in which there is allowable with respect to an asset a deduction for depreciation, amortization, or depletion, any expenditures (other than ordinary repairs) made to restore the asset or prolong its useful life shall be added to the asset account or charged against the appropriate reserve.

(b) Exceptions. (1) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation of taxable income shall be made in a manner which, in the opinion of the Commissioner, does clearly reflect income.

(2) A taxpayer whose sole source of income is wages need not keep formal books in order to have an accounting method. Tax returns, copies thereof, or other records may be sufficient to establish the use of the method of accounting used in the preparation of the taxpayer's income tax returns.

(c) Permissible methods—(1) In general. Subject to the provisions of paragraphs (a) and (b) of this section, a taxpayer may compute his taxable income under any of the following methods of accounting:

(i) Cash receipts and disbursements method. Generally, under the cash receipts and disbursements method in the computation of taxable income, all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made. For rules relating to constructive receipt, see § 1.451–2. For treatment of an expenditure attributable to more than one taxable year, see section 461(a) and paragraph (a)(1) of § 1.461–1.

(ii) Accrual method. (A) Generally, under an accrual method, income is to be included for the taxable year when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy. Under such a method, a liability is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. (See paragraph (a)(2)(iii)(A) of § 1.461–1 for examples of liabilities that may not be taken into account until after the taxable year incurred, and see §§ 1.461–4 through 1.461–6 for rules relating to economic performance.) Applicable provisions of the Code, the Income Tax Regulations, and other guidance published by the Secretary prescribe the manner in which a liability that has been incurred is taken into account. For example, section 162 provides that a deductible liability generally is taken into account in the taxable year incurred through a deduction from gross income. As a further example, under section 263 or 263A, a liability that relates to the creation of an asset having a useful life extending substantially beyond the close of the taxable year is taken into account in the taxable year incurred through capitalization (within the meaning of § 1.263A–1(c)(3)) and may later affect the computation of taxable income through depreciation or otherwise over a period including subsequent taxable years, in accordance with applicable Internal Revenue Code sections and related guidance.

(B) The term "liability" includes any item allowable as a deduction, cost, or expense for Federal income tax purposes. In addition to allowable deductions, the term includes any amount otherwise allowable as a capitalized cost, as a cost taken into account in computing cost of goods sold, as a cost allocable to a long-term contract, or as any other cost or expense. Thus, for example, an amount that a taxpayer expends or will expend for capital improvements to property must be incurred before the taxpayer may take the amount into account in computing its basis in the property. The term "liability" is not limited to items for which a legal obligation to pay exists at the time of payment. Thus, for example, amounts prepaid for goods or services and amounts paid without a legal obligation to do so may not be taken into account by an accrual basis taxpayer any earlier than the taxable year in which those amounts are incurred.

(C) No method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income. The method used by the taxpayer in determining when income is to be accounted for will generally be acceptable if it accords with generally accepted accounting principles, is consistently used by the taxpayer from year to year, and is consistent with the Income Tax Regulations. For example, a taxpayer engaged in a manufacturing business may account for sales of the taxpayer's product when the goods are shipped, when the product is delivered or accepted, or when title to the goods passes to the customers, whether or not billed, depending on the method regularly employed in keeping the taxpayer's books.

(iii) Other permissible methods. Special methods of accounting are described elsewhere in chapter 1 of the Code and the regulations thereunder. For example, see the following sections and the regulations thereunder: Sections 61 and 162, relating to the crop method of accounting; section 453, relating to the installment method; section 460, relating to the long-term contract methods. In addition, special methods of accounting for particular items of income and expense are provided under other sections of chapter 1. For example, see section 174, relating to research and experimental expenditures, and section 175, relating to soil and water conservation expenditures.

(iv) Combinations of the foregoing methods. (a) In accordance with the following rules, any combination of the foregoing methods of accounting will be permitted in connection with a trade or business if such combination clearly reflects income and is consistently used. Where a combination of methods of accounting includes any special methods, such as those referred to in subdivision (iii) of this subparagraph, the taxpayer must comply with the requirements relating to such special methods. A taxpayer using an accrual method of accounting with respect to purchases and sales may use the cash method in computing all other items of income and expense. However, a taxpayer who uses the cash method of accounting in computing gross income from his trade or business shall use the cash method in computing expenses of such trade or business. Similarly, a taxpayer who uses an accrual method of accounting in computing business expenses shall use an accrual method in computing items affecting gross income from his trade or business.

(b) A taxpayer using one method of accounting in computing items of income and deductions of his trade or business may compute other items of income and deductions not connected with his trade or business under a different method of accounting.

(2) Special rules. (i) In any case in which it is necessary to use an inventory the accrual method of accounting must be used with regard to purchases and sales unless otherwise authorized under subdivision (ii) of this subparagraph.

(ii) No method of accounting will be regarded as clearly reflecting income unless all items of gross profit and deductions are treated with consistency from year to year. The Commissioner may authorize a taxpayer to adopt or change to a method of accounting permitted by this chapter although the method is not specifically described in the regulations in this part if, in the opinion of the Commissioner, income is clearly reflected by the use of such method. Further, the Commissioner may authorize a taxpayer to continue the use of a method of accounting consistently used by the taxpayer, even though not specifically authorized by the regulations in this part, if, in the opinion of the Commissioner, income is clearly reflected by the use of such method. See section 446(a) and paragraph (a) of this section, which require that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books, and section 446(e) and paragraph (e) of this section, which require the prior approval of the Commissioner in the case of changes in accounting method.

(iii) The timing rules of § 1.1502–13 are a method of accounting for intercompany transactions (as defined in § 1.1502–13(b)(1)(i)), to be applied by each member of a consolidated group in addition to the member's other methods of accounting. See § 1.1502–13(a)(3)(i). This paragraph (c)(2)(iii) is applicable to consolidated return years beginning on or after November 7, 2001.

(d) Taxpayer engaged in more than one business. (1) Where a taxpayer has two or more separate and distinct trades or businesses, a different method of accounting may be used for each trade or business, provided the method used for each trade or business clearly reflects the income of that particular trade or business. For example, a taxpayer may account for the operations of a personal service business on the cash receipts and disbursements method and of a manufacturing business on an accrual method, provided such businesses are separate and distinct and the methods used for each clearly reflect income. The method first used in accounting for business income and deductions in connection with each trade or business, as evidenced in the taxpayer's income tax return in which such income or deductions are first reported, must be consistently followed thereafter.

(2) No trade or business will be considered separate and distinct for purposes of this paragraph unless a complete and separable set of books and records is kept for such trade or business.

(3) If, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer (for example, through inventory adjustments, sales, purchases, or expenses) so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer will not be considered to be separate and distinct.

(e) Requirement respecting the adoption or change of accounting method. (1) A taxpayer filing his first return may adopt any permissible method of accounting in computing taxable income for the taxable year covered by such return. See section 446(c) and paragraph (c) of this section for permissible methods. Moreover, a taxpayer may adopt any permissible method of accounting in connection with each separate and distinct trade or business, the income from which is reported for the first time. See section 446(d) and paragraph (d) of this section. See also section 446(a) and paragraph (a) of this section.

(2)(i) Except as otherwise expressly provided in chapter 1 of the Code and the regulations thereunder, a taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such new method for purposes of taxation, secure the consent of the Commissioner. Consent must be secured whether or not such method is proper or is permitted under the Internal Revenue Code or the regulations thereunder.

(ii)(a) A change in the method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. Although a method of accounting may exist under this definition without the necessity of a pattern of consistent treatment of an item, in most instances a method of accounting is not established for an item without such consistent treatment. A material item is any item that involves the proper time for the inclusion of the item in income or the taking of a deduction. Changes in method of accounting include a change from the cash receipts and disbursement method to an accrual method, or vice versa, a change involving the method or basis used in the valuation of inventories (see sections 471 and 472 and the regulations under sections 471 and 472), a change from the cash or accrual method to a long-term contract method, or vice versa (see § 1.460–4), certain changes in computing depreciation or amortization (see paragraph (e)(2)(ii)(d) of this section), a change involving the adoption, use or discontinuance of any other specialized method of computing taxable income, such as the crop method, and a change where the Internal Revenue Code and regulations under the Internal Revenue Code specifically require that the consent of the Commissioner must be obtained before adopting such a change.

(b) A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in computation of the foreign tax credit, net operating loss, percentage depletion, or investment credit). Also, a change in method of accounting does not include adjustment of any item of income or deduction that does not involve the proper time for the inclusion of the item of income or the taking of a deduction. For example, corrections of items that are deducted as interest or salary, but that are in fact payments of dividends, and of items that are deducted as business expenses, but that are in fact personal expenses, are not changes in method of accounting. In addition, a change in the method of accounting does not include an adjustment with respect to the addition to a reserve for bad debts. Although such adjustment may involve the question of the proper time for the taking of a deduction, such items are traditionally corrected by adjustment in the current and future years. For the treatment of the adjustment of the addition to a bad debt reserve (for example, for banks under section 585 of the Internal Revenue Code), see the regulations under section 166 of the Internal Revenue Code. A change in the method of accounting also does not include a change in treatment resulting from a change in underlying facts. For further guidance on changes involving depreciable or amortizable assets, see paragraph (e)(2)(ii)(d) of this section and § 1.1016–3(h).

(c) A change in an overall plan or system of identifying or valuing items in inventory is a change in method of accounting. Also a change in the treatment of any material item used in the overall plan for identifying or valuing items in inventory is a change in method of accounting.

(d) Changes involving depreciable or amortizable assets—(1) Scope. This paragraph (e)(2)(ii)(d) applies to property subject to section 167, 168, 197, 1400I, 1400L(c), to section 168 prior to its amendment by the Tax Reform Act of 1986 (100 Stat. 2121) (former section 168), or to an additional first year depreciation deduction provision of the Internal Revenue Code (for example, section 168(k), 1400L(b), or 1400N(d)).

(2) Changes in depreciation or amortization that are a change in method of accounting. Except as provided in paragraph (e)(2)(ii)(d)(3) of this section, a change in the treatment of an asset from nondepreciable or nonamortizable to depreciable or amortizable, or vice versa, is a change in method of accounting. Additionally, a correction to require depreciation or amortization in lieu of a deduction for the cost of depreciable or amortizable assets that had been consistently treated as an expense in the year of purchase, or vice versa, is a change in method of accounting. Further, except as provided in paragraph (e)(2)(ii)(d)(3) of this section, the following changes in computing depreciation or amortization are a change in method of accounting:

(i) A change in the depreciation or amortization method, period of recovery, or convention of a depreciable or amortizable asset.

(ii) A change from not claiming to claiming the additional first year depreciation deduction provided by, for example, section 168(k), 1400L(b), or 1400N(d), for, and the resulting change to the amount otherwise allowable as a depreciation deduction for the remaining adjusted depreciable basis (or similar basis) of, depreciable property that qualifies for the additional first year depreciation deduction (for example, qualified property, 50–percent bonus depreciation property, qualified New York Liberty Zone property, or qualified Gulf Opportunity Zone property), provided the taxpayer did not make the election out of the additional first year depreciation deduction (or did not make a deemed election out of the additional first year depreciation deduction; for further guidance, for example, see Rev. Proc. 2002–33 (2002–1 C.B. 963), Rev. Proc. 2003–50 (2003–2 C.B. 119), Notice 2006–77 (2006–40 I.R.B. 590), and § 601.601(d)(2)(ii)(b) of this chapter) for the class of property in which the depreciable property that qualifies for the additional first year depreciation deduction (for example, qualified property, 50–percent bonus depreciation property, qualified New York Liberty Zone property, or qualified Gulf Opportunity Zone property) is included.

(iii) A change from claiming the 30–percent additional first year depreciation deduction to claiming the 50–percent additional first year depreciation deduction for depreciable property that qualifies for the 50–percent additional first year depreciation deduction, provided the property is not included in any class of property for which the taxpayer elected the 30–percent, instead of the 50–percent, additional first year depreciation deduction (for example, 50–percent bonus depreciation property or qualified Gulf Opportunity Zone property), or a change from claiming the 50–percent additional first year depreciation deduction to claiming the 30–percent additional first year depreciation deduction for depreciable property that qualifies for the 30–percent additional first year depreciation deduction, including property that is included in a class of property for which the taxpayer elected the 30–percent, instead of the 50–percent, additional first year depreciation deduction (for example, qualified property or qualified New York Liberty Zone property), and the resulting change to the amount otherwise allowable as a depreciation deduction for the property's remaining adjusted depreciable basis (or similar basis). This paragraph (e)(2)(ii)(d)(2)(iii) does not apply if a taxpayer is making a late election or revoking a timely valid election under the applicable additional first year depreciation deduction provision of the Internal Revenue Code (for example, section 168(k), 1400L(b), or 1400N(d)) (see paragraph (e)(2)(ii)(d)(3)(iii) of this section).

(iv) A change from claiming to not claiming the additional first year depreciation deduction for an asset that does not qualify for the additional first year depreciation deduction, including an asset that is included in a class of property for which the taxpayer elected not to claim any additional first year depreciation deduction (for example, an asset that is not qualified property, 50–percent bonus depreciation property, qualified New York Liberty Zone property, or qualified Gulf Opportunity Zone property), and the resulting change to the amount otherwise allowable as a depreciation deduction for the property's depreciable basis.

(v) A change in salvage value to zero for a depreciable or amortizable asset for which the salvage value is expressly treated as zero by the Internal Revenue Code (for example, section 168(b)(4)), the regulations under the Internal Revenue Code (for example, § 1.197–2(f)(1)(ii)), or other guidance published in the Internal Revenue Bulletin.

(vi) A change in the accounting for depreciable or amortizable assets from a single asset account to a multiple asset account (pooling), or vice versa, or from one type of multiple asset account (pooling) to a different type of multiple asset account (pooling).

(vii) For depreciable or amortizable assets that are mass assets accounted for in multiple asset accounts or pools, a change in the method of identifying which assets have been disposed. For purposes of this paragraph (e)(2)(ii)(d)(2)(vii), the term mass assets means a mass or group of individual items of depreciable or amortizable assets that are not necessarily homogeneous, each of which is minor in value relative to the total value of the mass or group, numerous in quantity, usually accounted for only on a total dollar or quantity basis, with respect to which separate identification is impracticable, and placed in service in the same taxable year.

(viii) Any other change in depreciation or amortization as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(3) Changes in depreciation or amortization that are not a change in method of accounting. Section 1.446–1(e)(2)(ii)(b) applies to determine whether a change in depreciation or amortization is not a change in method of accounting. Further, the following changes in depreciation or amortization are not a change in method of accounting:

(i) Useful life. An adjustment in the useful life of a depreciable or amortizable asset for which depreciation is determined under section 167 (other than under section 168, section 1400I, section 1400L(c), former section 168, or an additional first year depreciation deduction provision of the Internal Revenue Code (for example, section 168(k), 1400L(b), or 1400N(d))) is not a change in method of accounting. This paragraph (e)(2)(ii)(d)(3)(i) does not apply if a taxpayer is changing to or from a useful life (or recovery period or amortization period) that is specifically assigned by the Internal Revenue Code (for example, section 167(f)(1), section 168(c), section 168(g)(2) or (3), section 197), the regulations under the Internal Revenue Code, or other guidance published in the Internal Revenue Bulletin and, therefore, such change is a change in method of accounting (unless paragraph (e)(2)(ii)(d)(3)(v) of this section applies). See paragraph (e)(2)(ii)(d)(5)(iv) of this section for determining the taxable year in which to correct an adjustment in useful life that is not a change in method of accounting.

(ii) Change in use. A change in computing depreciation or amortization allowances in the taxable year in which the use of an asset changes in the hands of the same taxpayer is not a change in method of accounting.

(iii) Elections. Generally, the making of a late depreciation or amortization election or the revocation of a timely valid depreciation or amortization election is not a change in method of accounting, except as otherwise expressly provided by the Internal Revenue Code, the regulations under the Internal Revenue Code, or other guidance published in the Internal Revenue Bulletin. This paragraph (e)(2)(ii)(d)(3)(iii) also applies to making a late election or revoking a timely valid election made under section 13261(g)(2) or (3) of the Revenue Reconciliation Act of 1993 (107 Stat. 312, 540) (relating to amortizable section 197 intangibles). A taxpayer may request consent to make a late election or revoke a timely valid election by submitting a request for a private letter ruling. For making or revoking an election under section 179 of the Internal Revenue Code, see section 179(c) and § 1.179–5.

(iv) Salvage value. Except as provided under paragraph (e)(2)(ii)(d)(2)(v) of this section, a change in salvage value of a depreciable or amortizable asset is not treated as a change in method of accounting.

(v) Placed-in-service date. Except as otherwise expressly provided by the Internal Revenue Code, the regulations under the Internal Revenue Code, or other guidance published in the Internal Revenue Bulletin, any change in the placed-in-service date of a depreciable or amortizable asset is not treated as a change in method of accounting. For example, if a taxpayer changes the placed-in-service date of a depreciable or amortizable asset because the taxpayer incorrectly determined the date on which the asset was placed in service, such a change is a change in the placed-in-service date of the asset and, therefore, is not a change in method of accounting. However, if a taxpayer incorrectly determines that a depreciable or amortizable asset is nondepreciable property and later changes the treatment of the asset to depreciable property, such a change is not a change in the placed-in-service date of the asset and, therefore, is a change in method of accounting under paragraph (e)(2)(ii)(d)(2) of this section. Further, a change in the convention of a depreciable or amortizable asset is not a change in the placed-in-service date of the asset and, therefore, is a change in method of accounting under paragraph (e)(2)(ii)(d)(2)(i) of this section. See paragraph (e)(2)(ii)(d)(5)(v) of this section for determining the taxable year in which to make a change in the placed-in-service date of a depreciable or amortizable asset that is not a change in method of accounting.

(vi) Any other change in depreciation or amortization as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(4) Item being changed. For purposes of a change in depreciation or amortization to which this paragraph (e)(2)(ii)(d) applies, the item being changed generally is the depreciation treatment of each individual depreciable or amortizable asset. However, the item is the depreciation treatment of each vintage account with respect to a depreciable asset for which depreciation is determined under § 1.167(a)–11 (class life asset depreciation range (CLADR) property). Similarly, the item is the depreciable treatment of each general asset account with respect to a depreciable asset for which general asset account treatment has been elected under section 168(i)(4) or the item is the depreciation treatment of each mass asset account with respect to a depreciable asset for which mass asset account treatment has been elected under former section 168(d)(2)(A). Further, a change in computing depreciation or amortization under section 167 (other than under section 168, section 1400I, section 1400L(c), former section 168, or an additional first year depreciation deduction provision of the Internal Revenue Code (for example, section 168(k), 1400L(b), or 1400N(d))) is permitted only with respect to all assets in a particular account (as defined in § 1.167(a)–7) or vintage account.

(5) Special rules. For purposes of a change in depreciation or amortization to which this paragraph (e)(2)(ii)(d) applies—

(i) Declining balance method to the straight line method for MACRS property. For tangible, depreciable property subject to section 168 (MACRS property) that is depreciated using the 200–percent or 150–percent declining balance method of depreciation under section 168(b)(1) or (2), a taxpayer may change without the consent of the Commissioner from the declining balance method of depreciation to the straight line method of depreciation in the first taxable year in which the use of the straight line method with respect to the adjusted depreciable basis of the MACRS property as of the beginning of that year will yield a depreciation allowance that is greater than the depreciation allowance yielded by the use of the declining balance method. When the change is made, the adjusted depreciable basis of the MACRS property as of the beginning of the taxable year is recovered through annual depreciation allowances over the remaining recovery period (for further guidance, see section 6.06 of Rev. Proc. 87–57 (1987–2 C.B. 687) and § 601.601(d)(2)(ii)(b) of this chapter).

(ii) Depreciation method changes for section 167 property. For a depreciable or amortizable asset for which depreciation is determined under section 167 (other than under section 168, section 1400I, section 1400L(c), former section 168, or an additional first year depreciation deduction provision of the Internal Revenue Code (for example, section 168(k), 1400L(b), or 1400N(d))), see § 1.167(e)–1(b), (c), and (d) for the changes in depreciation method that are permitted to be made without the consent of the Commissioner. For CLADR property, see § 1.167(a)–11(c)(1)(iii) for the changes in depreciation method for CLADR property that are permitted to be made without the consent of the Commissioner. Further, see § 1.167(a)–11(b)(4)(iii)(c) for how to correct an incorrect classification or characterization of CLADR property.

(iii) Section 481 adjustment. Except as otherwise expressly provided by the Internal Revenue Code, the regulations under the Internal Revenue Code, or other guidance published in the Internal Revenue Bulletin, no section 481 adjustment is required or permitted for a change from one permissible method of computing depreciation or amortization to another permissible method of computing depreciation or amortization for an asset because this change is implemented by either a cut-off method (for further guidance, for example, see section 2.06 of Rev. Proc. 97–27 (1997–1 C.B. 680), section 2.06 of Rev. Proc. 2002–9 (2002–1 C.B. 327), and § 601.601(d)(2)(ii)(b) of this chapter) or a modified cut-off method (under which the adjusted depreciable basis of the asset as of the beginning of the year of change is recovered using the new permissible method of accounting), as appropriate. However, a change from an impermissible method of computing depreciation or amortization to a permissible method of computing depreciation or amortization for an asset results in a section 481 adjustment. Similarly, a change in the treatment of an asset from nondepreciable or nonamortizable to depreciable or amortizable (or vice versa) or a change in the treatment of an asset from expensing to depreciating (or vice versa) results in a section 481 adjustment.

(iv) Change in useful life. This paragraph (e)(2)(ii)(d)(5)(iv) applies to an adjustment in the useful life of a depreciable or amortizable asset for which depreciation is determined under section 167 (other than under section 168, section 1400I, section 1400L(c), former section 168, or an additional first year depreciation deduction provision of the Internal Revenue Code (for example, section 168(k), 1400L(b), or 1400N(d))) and that is not a change in method of accounting under paragraph (e)(2)(ii)(d) of this section. For this adjustment in useful life, no section 481 adjustment is required or permitted. The adjustment in useful life, whether initiated by the Internal Revenue Service (IRS) or a taxpayer, is corrected by adjustments in the taxable year in which the conditions known to exist at the end of that taxable year changed thereby resulting in a redetermination of the useful life under § 1.167(a)–1(b) (or if the period of limitation for assessment under section 6501(a) has expired for that taxable year, in the first succeeding taxable year open under the period of limitation for assessment), and in subsequent taxable years. In other situations (for example, the useful life is incorrectly determined in the placed-in-service year), the adjustment in the useful life, whether initiated by the IRS or a taxpayer, may be corrected by adjustments in the earliest taxable year open under the period of limitation for assessment under section 6501(a) or the earliest taxable year under examination by the IRS but in no event earlier than the placed-in-service year of the asset, and in subsequent taxable years. However, if a taxpayer initiates the correction in useful life, in lieu of filing amended Federal tax returns (for example, because the conditions known to exist at the end of a prior taxable year changed thereby resulting in a redetermination of the useful life under § 1.167(a)–1(b)), the taxpayer may correct the adjustment in useful life by adjustments in the current and subsequent taxable years.

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(v) Change in placed-in-service date. This paragraph (e)(2)(ii)(d)(5)(v) applies to a change in the placed-in-service date of a depreciable or amortizable asset that is not a change in method of accounting under paragraph (e)(2)(ii)(d) of this section. For this change in placed-in-service date, no section 481 adjustment is required or permitted. The change in placed-in-service date, whether initiated by the IRS or a taxpayer, may be corrected by adjustments in the earliest taxable year open under the period of limitation for assessment under section 6501(a) or the earliest taxable year under examination by the IRS but in no event earlier than the placed-in-service year of the asset, and in subsequent taxable years. However, if a taxpayer initiates the change in placed-in-service date, in lieu of filing amended Federal tax returns, the taxpayer may correct the placed-in-service date by adjustments in the current and subsequent taxable years.

(iii) Examples. The rules of this paragraph (e) are illustrated by the following examples:

Example 1. Although the sale of merchandise is an income producing factor, and therefore inventories are required, a taxpayer in the retail jewelry business reports his income on the cash receipts and disbursements method of accounting. A change from the cash receipts and disbursements method of accounting to the accrual method of accounting is a change in the overall plan of accounting and thus is a change in method of accounting.

Example 2. A taxpayer in the wholesale dry goods business computes its income and expenses on the accrual method of accounting and files its Federal income tax returns on such basis except for real estate taxes which have been reported on the cash receipts and disbursements method of accounting. A change in the treatment of real estate taxes from the cash receipts and disbursements method to the accrual method is a change in method of accounting because such change is a change in the treatment of a material item within his overall accounting practice.

Example 3. A taxpayer in the wholesale dry goods business computes its income and expenses on the accrual method of accounting and files its Federal income tax returns on such basis. Vacation pay has been deducted in the year in which paid because the taxpayer did not have a completely vested vacation pay plan, and, therefore, the liability for payment did not accrue until that year. Subsequently, the taxpayer adopts a completely vested vacation pay plan that changes its year for accruing the deduction from the year in which payment is made to the year in which the liability to make the payment now arises. The change for the year of deduction of the vacation pay plan is not a change in method of accounting but results, instead, because the underlying facts (that is, the type of vacation pay plan) have changed.

Example 4. From 1968 through 1970, a taxpayer has fairly allocated indirect overhead costs to the value of inventories on a fixed percentage of direct costs. If the ratio of indirect overhead costs to direct costs increases in 1971, a change in the underlying facts has occurred. Accordingly, an increase in the percentage in 1971 to fairly reflect the increase in the relative level of indirect overhead costs is not a change in method of accounting but is a change in treatment resulting from a change in the underlying facts.

Example 5. A taxpayer values inventories at cost. A change in the basis for valuation of inventories from cost to the lower of cost or market is a change in an overall practice of valuing items in inventory. The change, therefore, is a change in method of accounting for inventories.

Example 6. A taxpayer in the manufacturing business has for many taxable years valued its inventories at cost. However, cost has been improperly computed since no overhead costs have been included in valuing the inventories at cost. The failure to allocate an appropriate portion of overhead to the value of inventories is contrary to the requirement of the Internal Revenue Code and the regulations under the Internal Revenue Code. A change requiring appropriate allocation of overhead is a change in method of accounting because it involves a change in the treatment of a material item used in the overall practice of identifying or valuing items in inventory.

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Example 7. A taxpayer has for many taxable years valued certain inventories by a method which provides for deducting 20 percent of the cost of the inventory items in determining the final inventory valuation. The 20 percent adjustment is taken as a "reserve for price changes." Although this method is not a proper method of valuing inventories under the Internal Revenue Code or the regulations under the Internal Revenue Code, it involves the treatment of a material item used in the overall practice of valuing inventory. A change in such practice or procedure is a change of method of accounting for inventories.

Example 8. A taxpayer has always used a base stock system of accounting for inventories. Under this system a constant price is applied to an assumed constant normal quantity of goods in stock. The base stock system is an overall plan of accounting for inventories which is not recognized as a proper method of accounting for inventories under the regulations. A change in this practice is, nevertheless, a change of method of accounting for inventories.

Example 9. In 2003, A1, a calendar year taxpayer engaged in the trade or business of manufacturing knitted goods, purchased and placed in service a building and its components at a total cost of $10,000,000 for use in its manufacturing operations. A1 classified the $10,000,000 as nonresidential real property under section 168(e). A1 elected not to deduct the additional first year depreciation provided by section 168(k) on its 2003 Federal tax return. As a result, on its 2003, 2004, and 2005 Federal tax returns, A1 depreciated the $10,000,000 under the general depreciation system of section 168(a), using the straight line method of depreciation, a 39–year recovery period, and the mid-month convention. In 2006, A1 completes a cost segregation study on the building and its components and identifies items that cost a total of $1,500,000 as section 1245 property. As a result, the $1,500,000 should have been classified in 2003 as 5–year property under section 168(e) and depreciated on A1's 2003, 2004, and 2005 Federal tax returns under the general depreciation system, using the 200–percent declining balance method of depreciation, a 5–year recovery period, and the half-year convention. Pursuant to paragraph (e)(2)(ii)(d)(2)(i) of this section, A1's change to this depreciation method, recovery period, and convention is a change in method of accounting. This method change results in a section 481 adjustment. The useful life exception under paragraph (e)(2)(ii)(d)(3)(i) of this section does not apply because the assets are depreciated under section 168.

Example 10. In 2003, B, a calendar year taxpayer, purchased and placed in service new equipment at a total cost of $1,000,000 for use in its plant located outside the United States. The equipment is 15–year property under section 168(e) with a class life of 20 years. The equipment is required to be depreciated under the alternative depreciation system of section 168(g). However, B incorrectly depreciated the equipment under the general depreciation system of section 168(a), using the 150–percent declining balance method, a 15–year recovery period, and the half-year convention. In 2010, the IRS examines B's 2007 Federal income tax return and changes the depreciation of the equipment to the alternative depreciation system, using the straight line method of depreciation, a 20–year recovery period, and the half-year convention. Pursuant to paragraph (e)(2)(ii)(d)(2)(i) of this section, this change in depreciation method and recovery period made by the IRS is a change in method of accounting. This method change results in a section 481 adjustment. The useful life exception under paragraph (e)(2)(ii)(d)(3)(i) of this section does not apply because the assets are depreciated under section 168.

Example 11. In May 2003, C, a calendar year taxpayer, purchased and placed in service equipment for use in its trade or business. C never held this equipment for sale. However, C incorrectly treated the equipment as inventory on its 2003 and 2004 Federal tax returns. In 2005, C realizes that the equipment should have been treated as a depreciable asset. Pursuant to paragraph (e)(2)(ii)(d)(2) of this section, C's change in the treatment of the equipment from inventory to a depreciable asset is a change in method of accounting. This method change results in a section 481 adjustment.

Example 12. Since 2003, D, a calendar year taxpayer, has used the distribution fee period method to amortize distributor commissions and, under that method, established pools to account for the distributor commissions (for further guidance, see Rev. Proc. 2000–38 (2000–2 C.B. 310) and § 601.601(d)(2)(ii)(b) of this chapter). A change in the accounting of distributor commissions under the distribution fee period method from pooling to single asset accounting is a change in method of accounting pursuant to paragraph (e)(2)(ii)(d)(2)(vi) of this section. This method change results in no section 481 adjustment because the change is from one permissible method to another permissible method.

Example 13. Since 2003, E, a calendar year taxpayer, has accounted for items of MACRS property that are mass assets in pools. Each pool includes only the mass assets that are placed in service by E in the same taxable year. E is able to identify the cost basis of each asset in each pool. None of the pools are general asset accounts under section 168(i)(4) and the regulations under section 168(i)(4). E identified any dispositions of these mass assets by specific identification. Because of changes in E's recordkeeping in 2006, it is impracticable for E to continue to identify disposed mass assets using specific identification. As a result, E wants to change to a first-in, first-out method under which the mass assets disposed of in a taxable year are deemed to be from the pool with the earliest placed-in-service year in existence as of the beginning of the taxable year of each disposition. Pursuant to paragraph (e)(2)(ii)(d)(2)(vii) of this section, this change is a change in method of accounting. This method change results in no section 481 adjustment because the change is from one permissible method to another permissible method.

Example 14. In August 2003, F, a calendar year taxpayer, purchased and placed in service a copier for use in its trade or business. F incorrectly classified the copier as 7–year property under section 168(e). F elected not to deduct the additional first year depreciation provided by section 168(k) on its 2003 Federal tax return. As a result, on its 2003 and 2004 Federal tax returns, F depreciated the copier under the general depreciation system of section 168(a), using the 200–percent declining balance method of depreciation, a 7–year recovery period, and the half-year convention. In 2005, F realizes that the copier is 5–year property and should have been depreciated on its 2003 and 2004 Federal tax returns under the general depreciation system using a 5–year recovery period rather than a 7–year recovery period. Pursuant to paragraph (e)(2)(ii)(d)(2)(i) of this section, F's change in recovery period from 7 to 5 years is a change in method of accounting. This method change results in a section 481 adjustment. The useful life exception under paragraph (e)(2)(ii)(d)(3)(i) of this section does not apply because the copier is depreciated under section 168.

Example 15. In 2004, G, a calendar year taxpayer, purchased and placed in service an intangible asset that is not an amortizable section 197 intangible and that is not described in section 167(f). G amortized the cost of the intangible asset under section 167(a) using the straight line method of depreciation and a determinable useful life of 13 years. The safe harbor useful life of 15 or 25 years under § 1.167(a)–3(b) does not apply to the intangible asset. In 2008, because of changing conditions, G changes the remaining useful life of the intangible asset to 2 years. Pursuant to paragraph (e)(2)(ii)(d)(3)(i) of this section, G's change in useful life is not a change in method of accounting because the intangible asset is depreciated under section 167 and G is not changing to or from a useful life that is specifically assigned by the Internal Revenue Code, the regulations under the Internal Revenue Code, or other guidance published in the Internal Revenue Bulletin.

Example 16. In July 2003, H, a calendar year taxpayer, purchased and placed in service "off-the-shelf" computer software and a new computer. The cost of the new computer and computer software are separately stated. H incorrectly included the cost of this software as part of the cost of the computer, which is 5–year property under section 168(e). On its 2003 Federal tax return, H elected to depreciate its 5–year property placed in service in 2003 under the alternative depreciation system of section 168(g) and H elected not to deduct the additional first year depreciation provided by section 168(k). The class life for a computer is 5 years. As a result, because H included the cost of the computer software as part of the cost of the computer hardware, H depreciated the cost of the software under the alternative depreciation system, using the straight line method of depreciation, a 5–year recovery period, and the half-year convention. In 2005, H realizes that the cost of the software should have been amortized under section 167(f)(1), using the straight line method of depreciation, a 36–month useful life, and a monthly convention. H's change from 5–years to 36–months is a change in method of accounting because H is changing to a useful life that is specifically assigned by section 167(f)(1). The change in convention from the half-year to the monthly convention also is a change in method of accounting. Both changes result in a section 481 adjustment.

Example 17. On May 1, 2003, I2, a calendar year taxpayer, purchased and placed in service new equipment at a total cost of $500,000 for use in its business. The equipment is 5–year property under section 168(e) with a class life of 9 years and is qualified property under section 168(k)(2). I2 did not place in service any other depreciable property in 2003. Section 168(g)(1)(A) through (D) do not apply to the equipment. I2 intended to elect the alternative depreciation system under section 168(g) for 5–year property placed in service in 2003. However, I2 did not make the election. Instead, I2 deducted on its 2003 Federal tax return the 30–percent additional first year depreciation attributable to the equipment and, on its 2003 and 2004 Federal tax returns, depreciated the remaining adjusted depreciable basis of the equipment under the general depreciation system under 168(a), using the 200–percent declining balance method, a 5–year recovery period, and the half-year convention. In 2005, I2 realizes its failure to make the alternative depreciation system election in 2003 and files a Form 3115, "Application for Change in Accounting Method," to change its method of depreciating the remaining adjusted depreciable basis of the 2003 equipment to the alternative depreciation system. Because this equipment is not required to be depreciated under the alternative depreciation system, I2 is attempting to make an election under section 168(g)(7). However, this election must be made in the taxable year in which the equipment is placed in service (2003) and, consequently, I2 is attempting to make a late election under section 168(g)(7). Accordingly, I2's change to the alternative depreciation system is not a change in accounting method pursuant to paragraph (e)(2)(ii)(d)(3)(iii) of this section. Instead, I2 must submit a request for a private letter ruling under § 301.9100–3 of this chapter, requesting an extension of time to make the alternative depreciation system election on its 2003 Federal tax return.

Example 18. On December 1, 2004, J, a calendar year taxpayer, purchased and placed in service 20 previously-owned adding machines. For the 2004 taxable year, J incorrectly classified the adding machines as items in its "suspense" account for financial and tax accounting purposes. Assets in this suspense account are not depreciated until reclassified to a depreciable fixed asset account. In January 2006, J realizes that the cost of the adding machines is still in the suspense account and reclassifies such cost to the appropriate depreciable fixed asset account. As a result, on its 2004 and 2005 Federal tax returns, J did not depreciate the cost of the adding machines. Pursuant to paragraph (e)(2)(ii)(d)(2) of this section, J's change in the treatment of the adding machines from nondepreciable assets to depreciable assets is a change in method of accounting. The placed-in-service date exception under paragraph (e)(2)(ii)(d)(3)(v) of this section does not apply because the adding machines were incorrectly classified in a nondepreciable suspense account. This method change results in a section 481 adjustment.

Example 19. In December 2003, K, a calendar year taxpayer, purchased and placed in service equipment for use in its trade or business. However, K did not receive the invoice for this equipment until January 2004. As a result, K classified the equipment on its fixed asset records as being placed in service in January 2004. On its 2004 and 2005 Federal tax returns, K depreciated the cost of the equipment. In 2006, K realizes that the equipment was actually placed in service during the 2003 taxable year and, therefore, depreciation should have began in the 2003 taxable year instead of the 2004 taxable year. Pursuant to paragraph (e)(2)(ii)(d)(3)(v) of this section, K's change in the placed-in-service date of the equipment is not a change in method of accounting.

(3)(i) Except as otherwise provided under the authority of paragraph (e)(3)(ii) of this section, to secure the Commissioner's consent to a taxpayer's change in method of accounting the taxpayer generally must file an application on Form 3115, "Application for Change in Accounting Method," with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting. See §§ 1.381(c)(4)–1(d)(2) and 1.381(c)(5)–1(d)(2) for rules allowing additional time, in some circumstances, for the filing of an application on Form 3115 with respect to a transaction to which section 381(a) applies. To the extent applicable, the taxpayer must furnish all information requested on the Form 3115. This information includes all classes of items that will be treated differently under the new method of accounting, any amounts that will be duplicated or omitted as a result of the proposed change, and the taxpayer's computation of any adjustments necessary to prevent such duplications or omissions. The Commissioner may require such other information as may be necessary to determine whether the proposed change will be permitted. Permission to change a taxpayer's method of accounting will not be granted unless the taxpayer agrees to the Commissioner's prescribed terms and conditions for effecting the change, including the taxable year or years in which any adjustment necessary to prevent amounts from being duplicated or omitted is to be taken into account. See section 481 and the regulations thereunder, relating to certain adjustments resulting from accounting method changes, and section 472 and the regulations thereunder, relating to adjustments for changes to and from the last-in, first-out inventory method. For any Form 3115 filed on or after May 15, 1997, see § 1.446–1T(e)(3)(i)(B).

(ii) Notwithstanding the provisions of paragraph (e)(3)(i) of this section, the Commissioner may prescribe administrative procedures under which taxpayers will be permitted to change their method of accounting. The administrative procedures shall prescribe those terms and conditions necessary to obtain the Commissioner's consent to effect the change and to

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prevent amounts from being duplicated or omitted. The terms and conditions that may be prescribed by the Commissioner may include terms and conditions that require the change in method of accounting to be effected on a cut-off basis or by an adjustment under section 481(a) to be taken into account in the taxable year or years prescribed by the Commissioner.

(iii) This paragraph (e)(3) applies to Forms 3115 filed on or after December 31, 1997. For other Forms 3115, see § 1.446–1(e)(3) in effect prior to December 31, 1997 (§ 1.446–1(e)(3) as contained in the 26 CFR part 1 edition revised as of April 1, 1997).

(4) Effective date—(i) In general. Except as provided in paragraphs (e)(3)(iii), (e)(4)(ii), and (e)(4)(iii) of this section, paragraph (e) of this section applies on or after December 30, 2003. For the applicability of regulations before December 30, 2003, see § 1.446–1(e) in effect prior to December 30, 2003 (§ 1.446–1(e) as contained in 26 CFR part 1 edition revised as of April 1, 2003).

(ii) Changes involving depreciable or amortizable assets. With respect to paragraph (e)(2)(ii)(d) of this section, paragraph (e)(2)(iii) Examples 9 through 19 of this section, and the language "certain changes in computing depreciation or amortization (see paragraph (e)(2)(ii)(d) of this section)" in the last sentence of paragraph (e)(2)(ii)(a) of this section—

(A) For any change in depreciation or amortization that is a change in method of accounting, this section applies to such a change in method of accounting made by a taxpayer for a depreciable or amortizable asset placed in service by the taxpayer in a taxable year ending on or after December 30, 2003; and

(B) For any change in depreciation or amortization that is not a change in method of accounting, this section applies to such a change made by a taxpayer for a depreciable or amortizable asset placed in service by the taxpayer in a taxable year ending on or after December 30, 2003.

(iii) Effective/applicability date for paragraph (e)(3)(i). The rules of paragraph (e)(3)(i) of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

Credits

[T.D. 6500, 25 FR 11708, Nov. 26, 1960, as amended by T.D. 7073, 35 FR 17710, Nov. 18, 1970; T.D. 7285, 38 FR 26184, Sept. 19, 1973; T.D. 8067, 51 FR 378, Jan. 6, 1986; T.D. 8131, 52 FR 10084, March 30, 1987; T.D. 8408, 57 FR 12419, April 10, 1992; T.D. 8482, 58 FR 42233, Aug. 9, 1993; T.D. 8608, 60 FR 40078, Aug. 7, 1995; T.D. 8719, 62 FR 26741, May 15, 1997; T.D. 8742, 62 FR 68169, Dec. 31, 1997; T.D. 8929, 66 FR 2223, Jan. 11, 2001; T.D. 9025, 67 FR 76985, Dec. 16, 2002; T.D. 9105, 69 FR 8, Jan. 2, 2004; T.D. 9307, 71 FR 78068, Dec. 28, 2006; T.D. 9534, 76 FR 45688, Aug. 1, 2011]

Historical Treasury Decisions: T.D. 6282, Dec. 24, 1957; T.D. 6584, Dec. 20, 1961; T.D. 7285, Sept. 14, 1973.

AUTHORITY: Section 1.901(j)–1 also issued under 26 U.S.C. 901(j)(4).; Section 1.987–12 is issued under 26 U.S.C. 987 and 989.; Section 1.7701(l)–4 also issued under 26 U.S.C. 7701(l) and 954(c)(6)(A).

Notes of Decisions (538)

Current through May 14, 2020, 85 FR 29317.

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Code of Federal Regulations
Title 26. Internal Revenue
Chapter I. Internal Revenue Service, Department of the Treasury
Subchapter A. Income Tax
Part 1. Income Taxes (Refs & Annos)
Normal Taxes and Surtaxes
Deferred Compensation, Etc.
Methods of Accounting
Inventories

26 C.F.R. § 1.471–2, Treas. Reg. § 1.471–2

§ 1.471–2 Valuation of inventories.

Currentness

(a) Section 471 provides two tests to which each inventory must conform:

(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and

(2) It must clearly reflect the income.

(b) It follows, therefore, that inventory rules cannot be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order to clearly reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is in accord with §§ 1.471–1 through 1.471–11.

(c) The bases of valuation most commonly used by business concerns and which meet the requirements of section 471 are (1) cost and (2) cost or market, whichever is lower. (For inventories by dealers in securities, see § 1.471–5.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less direct cost of disposition, whether subparagraph (1) or (2) of this paragraph is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value. Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date. The burden of proof will rest upon the taxpayer to show that such exceptional goods as are valued upon such selling basis come within the classifications indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.

(d) In respect of normal goods, whichever method is adopted must be applied with reasonable consistency to the entire inventory of the taxpayer's trade or business except as to those goods inventoried under the last-in, first-out method authorized by section 472 or to animals inventoried under the elective unit, livestock-price-method authorized by § 1.471–6. See paragraph (d) of § 1.446–1 for rules permitting the use of different methods of accounting if the taxpayer has more than one trade or business. Where the taxpayer is engaged in more than one trade or business the Commissioner may require that the method of valuing

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inventories with respect to goods in one trade or business also be used with respect to similar goods in other trades or businesses if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income. Taxpayers were given an option to adopt the basis of either (1) cost or (2) cost or market, whichever is lower, for their 1920 inventories. The basis properly adopted for that year or any subsequent year is controlling, and a change can now be made only after permission is secured from the Commissioner. Application for permission to change the basis of valuing inventories shall be made in writing and filed with the Commissioner as provided in paragraph (e) of § 1.446–1. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired. But see section 472 as to last-in, first-out inventories. Where the taxpayer maintains book inventories in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year), the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such book inventories should be verified by physical inventories at reasonable intervals and adjusted to conform therewith.

(e) Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the district director, and the taxpayer must satisfy the district director of the correctness of the prices adopted.

(f) The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with the regulations in this part:

(1) Deducting from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(2) Taking work in process, or other parts of the inventory, at a nominal price or at less than its proper value.

(3) Omitting portions of the stock on hand.

(4) Using a constant price or nominal value for so-called normal quantity of materials or goods in stock.

(5) Including stock in transit, shipped either to or from the taxpayer, the title to which is not vested in the taxpayer.

(6) Segregating indirect production costs into fixed and variable production cost classifications (as defined in § 1.471–11(b)(3)(ii)) and allocating only the variable costs to the cost of goods produced while treating fixed costs as period costs which are currently deductible. This method is commonly referred to as the "direct cost" method.

(7) Treating all or substantially all indirect production costs (whether classified as fixed or variable) as period costs which are currently deductible. This method is generally referred to as the "prime cost" method.

Credits

[T.D. 6500, 25 FR 11724, Nov. 26, 1960, as amended by T.D. 7285, 38 FR 26185, Sept. 19, 1973]

Historical Treasury Decisions: T.D. 6336, Dec. 1, 1958; T.D. 7285, Sept. 14, 1973.

AUTHORITY: Section 1.901(j)–1 also issued under 26 U.S.C. 901(j)(4).; Section 1.987–12 is issued under 26 U.S.C. 987 and 989.; Section 1.7701(l)–4 also issued under 26 U.S.C. 7701(l) and 954(c)(6)(A).

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Current through May 14, 2020, 85 FR 29317.

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Inventories

26 C.F.R. § 1.471–3, Treas. Reg. § 1.471–3

§ 1.471–3 Inventories at cost.

Effective: November 20, 2018
Currentness

Cost means:

(a) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(b) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods. But see § 1.263A–1(d)(2)(iv)(C) for special rules for certain direct material costs that in certain cases are permitted to be capitalized as additional section 263A costs by taxpayers using a simplified method under § 1.263A–2(b) or (c) or § 1.263A–3(d). For taxpayers acquiring merchandise for resale that are subject to the provisions of section 263A, see §§ 1.263A–1 and 1.263A–3 for additional amounts that must be included in inventory costs.

(c) In the case of merchandise produced by the taxpayer since the beginning of the taxable year, (1) the cost of raw materials and supplies entering into or consumed in connection with the product, (2) expenditures for direct labor, and (3) indirect production costs incident to and necessary for the production of the particular article, including in such indirect production costs an appropriate portion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit. See §§ 1.263A–1 and 1.263A–2 for more specific rules regarding the treatment of production costs.

(d) In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. Among such cases are:

(1) Farmers and raisers of livestock (see § 1.471–6);

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(2) Miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike (see § 1.471–7); and

(3) Retail merchants who use what is known as the "retail method" in ascertaining approximate cost (see § 1.471–8).

(e) Sales-based vendor allowances—(1) Treatment of sales-based vendor chargebacks—(i) In general. A sales-based vendor chargeback is an allowance, discount, or price rebate that a taxpayer becomes unconditionally entitled to by selling a vendor's merchandise to specific customers identified by the vendor at a price determined by the vendor. A sales-based vendor chargeback decreases cost of goods sold and does not reduce the cost of goods on hand at the end of the taxable year.

(ii) Example. The following example illustrates the provisions of this paragraph (e)(1).

Example. (i) W is a wholesaler of pharmaceuticals. W purchases Drug X from the manufacturer, M, for $10x per unit. M has agreements with specific customers that allow those customers to acquire Drug X from M's wholesalers for $6x per unit. Under an agreement between W and M, W is required to sell Drug X to specific customers at the prices M has negotiated with such customers ($6x per unit) and, in exchange, M agrees to provide a price rebate to W equal to the difference between W's cost for Drug X and the price W is required to charge specific customers under the agreement (a difference of $4x per unit). W sells Drug X to specific customer Y for $6x. Under the agreement between W and M, the price rebate can be paid to W, credited against M's invoice to W for W's purchase of Drug X, or it can be credited to W's future purchases of drugs from M.

(ii) Under the terms of the agreement, W is unconditionally entitled to the price rebate of Drug X when it sells Drug X to specific customer Y, a specifically identified customer of M. The price rebate received by W for the sale of Drug X to Y is a sales-based vendor chargeback. Therefore, the amount of the sales-based vendor charge back, $4x per unit for Drug X, whether paid to W, credited against M's invoice to W for W's purchase of Drug X or credited against a future purchase, decreases cost of goods sold and does not reduce the cost of Drug X on hand at the end of the taxable year.

(2) Treatment of other sales-based vendor allowances. [Reserved]

(f) Notwithstanding the other rules of this section, cost shall not include an amount which is of a type for which a deduction would be disallowed under section 162(c), (f), or (g) and the regulations thereunder in the case of a business expense.

(g) Effective/applicability date. Paragraph (f) of this section applies to taxable years ending on or after January 13, 2014.

Credits

[T.D. 6500, 25 FR 11725, Nov. 26, 1960, as amended by T.D. 7285, 38 FR 26185, Sept. 19, 1973; T.D. 7345, 40 FR 7439, Feb. 20, 1975; T.D. 8131, 52 FR 10084, March 30, 1987; T.D. 8482, 58 FR 42233, Aug. 9, 1993; T.D. 9652, 79 FR 2098, Jan. 13, 2014; T.D. 9843, 83 FR 58498, Nov. 20, 2018]

Historical Treasury Decisions: T.D. 6336, Dec. 1, 1958; T.D. 7285, Sept. 14, 1973; T.D. 8131, March 24, 1987.

AUTHORITY: Section 1.901(j)–1 also issued under 26 U.S.C. 901(j)(4).; Section 1.987–12 is issued under 26 U.S.C. 987 and 989.; Section 1.7701(l)–4 also issued under 26 U.S.C. 7701(l) and 954(c)(6)(A).

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Notes of Decisions (9)

Current through May 14, 2020, 85 FR 29317.

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