

**BRING THIS TO CLASS:**

1. **Introduction to basic retirement planning**
2. **Reg. 1.451-1 & 2 - Constructive Receipt**
3. **Reg. Sec. 1.404(b) - Employers Deduction Delayed if Paid after 2 ½ Months**
4. **Sec. 402 (a) and (b) - Sec 402(b) Nonqualified plans**
5. **Reg. 1.83(e) - “Property” includes money deposited into a trust**
6. **Sec. 83 - Compensation in Property**
7. **Rev Rul 60 - 31**
8. **Sec. 409A**
9. **Problems**

**BASIC RETIREMENT PLANNING ISSUES**

- I. **OBJECTIVE:** To have the same standard of living at retirement that you had during your working years. Estimates range that your retirement income should be between 70% and 80% of your pre-retirement income (after adjustments for inflation) to maintain your lifestyle.

Reasons: You are free of work-related costs (clothing, commuting, etc.) which are often 5% of your budget.  
You no longer pay 7.65% social security taxes on your wages. Instead - you *collect* social security!  
Your home may be paid for - no more mortgage payments.

II. **SOURCES OF RETIREMENT INCOME (THE "THREE LEGGED STOOL")**

- A. Social Security - minimal "safety net" payments
- B. Company pension
- C. Your own savings
- D. 4th leg- working after retirement age

III. **SAVING VEHICLES - Tax-Sheltered Arrangements Provide Best Results**

A. **Tax-sheltered "qualified plans".**

The principal tax advantage offered by qualified retirement plans is *tax deferral*:

1. You or your employer obtain a tax deduction in the year that a contribution is made to an IRA or to a qualified retirement plan,
2. the investment income of the trust compounds tax-free, and
3. you are finally taxed in the year that amounts are distributed to you.

B. **Types of Qualified Retirement Plans**

**1. Section 401(a) Plans (Company plans and “Keogh” plans)**

*Account Plans*

- |                         |                   |
|-------------------------|-------------------|
| Money purchase pensions | Stock bonus plans |
| Profit sharing plans    | ESOPs             |
| Section 401(k) plans    |                   |

*Annuity Plans*

- Defined benefit plans
- Annuity plans

**2. Individual Retirement Accounts (Section 408 Plans)**

- Individual Retirement Accounts
- Individual Retirement Annuities
- Simplified Employee Pension"SEP" (usually IRA accounts)
- SIMPLE Plans (also accounts in IRAs)
- Roth IRAs (Section 408A)

**4. Charities and Government Employers (Section 403(b and 457(b))**

- Tax-sheltered custodial accounts; Tax-sheltered annuities

**IV. FOCUS ON IRAs: ELIGIBILITY, ROTH IRAs**

A. Conventional Way To Save for Retirement

1. Investing without on IRA, 401(k) plan, or 403(b) plan
2. Examples: Savings accounts, certificates of deposit, mutual funds, money market funds

B. Deductible IRA

1. 2004: Maximum contribution: \$3,000 per year (\$6,000 for married couples)  
2005: \$4,000 per year 2008: \$5,000 per year
2. Must have income from work (employee or self-employed)
3. Advantage: Tax-deduction from contribution AND income in IRA compounds tax-free until distributed.

*At death, these IRA assets are subject to the worst estate tax: the combination of both estate and income taxes can easily take 80% of these assets and leave only 20% for your descendants. The same 80% tax can apply to all of your assets in any sort of qualified retirement plan.*

C. Non-Deductible IRA

1. Same as deductible IRA, but some people are not eligible for a deductible IRA if they are:
  - a. Covered by a plan at work, and
  - b. Have adjusted gross income in excess of the threshold :

Year	Married filing jointly	Single filers
	\$ 80,000 - \$ 100,000	\$ 50,000 - \$ 60,000

2. Partial or no tax deduction at time of contribution.
3. Advantage: income in IRA compounds tax-free until distributed.

D. Roth IRA

1. Like other IRA, must have income from work.
2. Maximum contribution is \$3,500 or 100% of income.
3. Contribution is limited if adjusted gross income is over \$95,000 (\$150,000 for married filing jointly). A Roth IRA is *not available* to a person whose adjusted gross income is over \$110,000 (\$160,000 for married filing jointly).
4. No tax deduction at time of contribution
5. MAIN APPEAL: After five years, all distributions of the accumulated investment income from a Roth IRA will be *tax-exempt* if the distribution is made
  - (a) to purchase a first home (maximum \$10,000 available),
  - (b) after the age of 59 ½ (or upon disability, if sooner), or
  - (c) to a successor beneficiary after the account owner's death.

Amounts in deductible IRAs may be transferred to Roth IRAs provided the taxpayer's AGI for the transfer year is \$ 100,000 or less. Transferred amounts are included in income, but exempt from the early withdrawal tax. No payments allocable to the transferred amounts can be qualified distributions unless they are made more than five years after the transfer.

V. COMPARISON OF SAVING FOR RETIREMENT WITH (1) NO QUALIFIED PLAN, (2) A CONVENTIONAL QUALIFIED PLAN, (3) A NON-DEDUCTIBLE IRA OR (4) A ROTH IRA (PLEASE SEE THE NEXT PAGES FOR EXAMPLES)

*Should regular IRAs be converted into Roth IRAs?* Each person should probably do a cost-benefit analysis based on his or her own situation.

*If a person will be subject to a higher tax rate in the future, then accumulating assets in a Roth IRA will generally be superior, whereas the deductible IRA will generally be superior if the person will be subject to lower tax rates in the future.*

*A person who is always subject to the same marginal income tax rate will accumulate an identical amount of after-tax wealth with either a Roth IRA or a deductible IRA.*

**EXAMPLE:** assume a person in a 40% marginal income tax bracket received a \$1,000 bonus. The individual could take the bonus and either (1) contribute the entire \$1,000 to a deductible IRA and pay a 40% tax when the assets are distributed or (2) contribute the \$600 remaining after tax to a Roth IRA and pay no tax when the assets are distributed. Either approach will produce the same amount of after-tax wealth. The situation can be expressed by the formula:

After-Tax Cash Upon Distribution

Deductible IRA

Roth IRA

(Income Tax Paid When Distributed) (Income Tax Paid When Contributed)

$$((K) \times (1+i)^N) \times (1-T) = ((K) \times (1-T)) \times (1+i)^N$$

where "K" represents the pre-tax compensation, "i" represents the investment yield in the IRA, "N" represents the number of years before distribution and "T" represents the marginal tax rate. Of course, if the tax rate changes from the year of contribution to the year of distribution, then the amounts will not be equal.

*One way that a Roth IRA will accumulate a greater amount of after-tax wealth than a deductible IRA is if the maximum \$2,000 annual limit is contributed to the Roth IRA. All IRAs have a \$2,000 annual contribution limitation, but since the Roth IRA contribution is made with after-tax dollars, it is the equivalent of making a \$3,333 contribution to a deductible IRA (a person in a 40% income tax bracket would have to earn \$3,333 to have \$2,000 after taxes).*

**ESTATE PLANNING:** A few commentators contend that in a few situations, it may make sense to convert a regular IRA into a Roth IRA in order to reduce the estate tax. The conversion triggers an income tax liability that can reduce the amount of estate tax at death, PLUS the heirs will receive tax-exempt income instead of the taxable income in respect of a decedent that they would receive from a conventional IRA.

## COMPARISON OF SAVING FOR RETIREMENT WITH (1) NO IRA, (2) DEDUCTIBLE IRA, (3) NON-DEDUCTIBLE IRA OR (4) ROTH IRA

### ASSUMPTIONS:

Bonus from work available for saving:	\$ 1,000
Investment Yield:	10.00%
Tax Rate During Investment Years	40.00%
Tax Rate During Retirement Years	40.00%

CONVENTIONAL SAVINGS				DEDUCTIBLE IRA			
	Principal	Income	Tax	Principal	Income	Tax	
Balance >	\$1,000			\$1,000			
Less tax >	<u>400</u>			<u>-0-</u>			
Amount to Invest	\$600			\$1,000			
Year							
	1	600.00	60.00	24.00	1,000.00	100.00	0.00
	2	636.00	63.60	25.44	1,100.00	110.00	0.00
	3	674.16	67.42	26.97	1,210.00	121.00	0.00
	4	714.61	71.46	28.58	1,331.00	133.10	0.00
	5	757.49	75.75	30.30	1,464.10	146.41	0.00
	6	802.94	80.29	32.12	1,610.51	161.05	0.00
	7	851.11			1,771.56		
Withdraw	\$851.11			\$1,771.56			
Inc. Tax	0.00		40.00%---->>	708.62	<i>EXTRA CASH</i>		
10% Penalty	<u>0.00</u>	(Penalty if under age 59 ½)>		<u>Possible</u>	<i>Without</i>	<i>With 10%</i>	
			\$177.16		<i>Penalty</i>	<i>Penalty</i>	
Total	\$851.11			\$1,062.94	\$211.83	\$34.67	
	,=====			,=====			

## COMPARISON OF INVESTING \$1,000 EVERY YEAR

	CONVENTIONAL SAVINGS		DEDUCTIBLE IRA	
<b>10 years</b>	7,908		15,937	
Inc Tax	<u>-0-</u>	40.00% -->	<u>6,375</u>	
<b>After Tax</b>	<b>7,908</b>		<b>9,562</b>	<b>20.91% more</b>
	=====		=====	
<b>20 years</b>	22,071		57,275	
Inc Tax	<u>-0-</u>	40.00% -->	<u>22,910</u>	
<b>After Tax</b>	<b>22,071</b>		<b>34,365</b>	<b>55.70% more</b>
	=====		=====	
<b>30 years</b>	47,435		164,494	
Inc Tax	<u>-0-</u>	40.00% -->	<u>65,798</u>	
<b>After Tax</b>	<b>47,435</b>		<b>98,696</b>	<b>108.07% more</b>

## COMPARISON OF SAVING FOR RETIREMENT WITH (1) NO IRA, (2) DEDUCTIBLE IRA, (3) NON-DEDUCTIBLE IRA OR (4) ROTH IRA

### ASSUMPTIONS:

Bonus from work available for saving:	\$ 1,000
Investment Yield:	10.00%
Tax Rate During Investment Years	40.00%
Tax Rate During Retirement Years	40.00%

NON-DEDUCTIBLE IRA				ROTH IRA			
	Principal	Income	Tax	Principal	Income	Tax	
Balance >	\$1,000			\$1,000			
Less tax >	<u>400</u>			<u>400</u>			
Amount to Invest	\$600			\$600			
Year							
1	600.00	60.00	0.00	600.00	60.00	0.00	
2	660.00	66.00	0.00	660.00	66.00	0.00	
3	726.00	72.60	0.00	726.00	72.60	0.00	
4	798.60	79.86	0.00	798.60	79.86	0.00	
5	878.46	87.85	0.00	878.46	87.85	0.00	
6	966.31	96.63	0.00	966.31	96.63	0.00	
7	1,062.94			1,062.94			
Withdraw	\$1,062.94			\$1,062.94			
Inc. Tax	185.17	<<--40.00%		0.00			(Roth is tax-free)
10% Penalty (if under age 59.5)	possible	<i>Without</i>	<i>With 10%</i>				
	-----	<i>Penalty</i>	<i>Penalty</i>	-----			
Total	\$877.76	\$26.65	(\$19.64)	\$1,062.94			(Identical to a -----Deductible IRA)
	=====			=====			

## COMPARISON OF INVESTING \$1,000 EVERY YEAR

	NON-DEDUCTIBLE IRA		ROTH IRA	
<b>10 years</b>	9,562		9,562	
Inc Tax	<u>1,425</u>	<<-- 40.00%	<u>-0-</u>	
<b>After Tax</b>	<b>8,137</b>	<b>2.90% more</b>	<b>9,562</b>	<b>20.91% more</b>
	=====		=====	
<b>20 years</b>	34,365		34,365	
Inc Tax	<u>8,946</u>	<<-- 40.00%	<u>-0-</u>	
<b>After Tax</b>	<b>25,419</b>	<b>15.17% more</b>	<b>34,365</b>	<b>55.70% more</b>
	=====		=====	
<b>30 years</b>	98,696		98,696	
Inc Tax	<u>32,278</u>	<<-- 40.00%	<u>-0-</u>	
<b>After Tax</b>	<b>66,418</b>	<b>40.02% more</b>	<b>98,696</b>	<b>108.07% more</b>

### **Reg. Sec. 1.451-1 General rule for taxable year of inclusion.**

**(a) General rule.** Gains, profits, and income are to be included in gross income for the taxable year in which they are *actually or constructively received* by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Under an *accrual method* of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. Therefore, under such a method of accounting if, in the case of compensation for services, no determination can be made as to the right to such compensation or the amount thereof until the services are completed, the amount of compensation is ordinarily income for the taxable year in which the determination can be made. Under the cash receipts and disbursements method of accounting, such an amount is includible in gross income when actually or constructively received. Where an amount of income is properly accrued on the basis of a reasonable estimate and the exact amount is subsequently determined, the difference, if any, shall be taken into account for the taxable year in which such determination is made....

### **Reg. Sec. 1.451-2 Constructive receipt of income.**

**(a) General rule.** Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise *made available so that he may draw upon it at any time*, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. *However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.* ...

**(b) Examples of constructive receipt** Amounts payable with respect to interest coupons which have matured and are payable but which have not been cashed are constructively received in the taxable year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. Dividends on corporate stock are constructively received when unqualifiedly made subject to the demand of the shareholder....

### **Sec. 1.404(b)-1T Method or arrangement of contributions, etc., deferring the receipt of compensation or providing for deferred benefits. (Temporary)**

**Q-2: When does a plan, or method or arrangement, defer the receipt of compensation or benefits for purposes of section 404 (a), (b), and (d)?**

A-2: (a) For purposes of section 404 (a), (b), and (d), a plan, or method or arrangement, defers the receipt of compensation or benefits to the extent it is one under which *an employee receives compensation or benefits more than a brief period of time after the end of the employer's taxable year in which the services creating the right to such compensation or benefits are performed.* ....For the treatment of expenses with respect to transactions between related taxpayers, see section 267.

**(b)(1) A plan, or method or arrangement, shall be presumed to be one deferring the receipt of compensation for more than a brief period of time after the end of an employer's taxable year to the extent that compensation is received after the 15th day of the 3rd calendar month after the end of the employer's taxable year in which the related services are rendered ("the 2 1/2 month period").** Thus, for example, salary under an employment contract or a bonus under a year-end bonus declaration is presumed to be paid under a plan, or method or arrangement, deferring the receipt of compensation, to the extent that the salary or bonus is received beyond the applicable 2 1/2 month period. Further, salary or a year-end bonus received beyond the applicable 2 1/2 month period by one employee shall be presumed to

constitute payment under a plan, or method or arrangement, deferring the receipt of compensation for such employee even though salary or bonus payments to all other employees are not similarly treated because they are received within the 2 1/2 month period. Benefits are "deferred benefits" if, assuming the benefits were cash compensation, such benefits would be considered deferred compensation. Thus, a plan, or method or arrangement, shall be presumed to be one providing for deferred benefits to the extent benefits for services are received by an employee after the 2 1/2 month period following the end of the employer's taxable year in which the related services are rendered....

*(c) A plan, or method or arrangement, shall not be considered as deferring the receipt of compensation or benefits for more than a brief period of time after the end of the employer's taxable year to the extent that compensation or benefits are received by the employee on or before the end of the applicable 2 1/2 month period..* Thus, for example, salary under an employment contract or a bonus under a year-end bonus declaration is not considered paid under a plan, or method or arrangement, deferring the receipt of compensation to the extent that such salary or bonus is received by the employee on or before the end of the applicable 2 1/2 month period.

## **INTERNAL REVENUE CODE**

### **STATUTE: § 402. Taxability of beneficiary of employees' trust.**

**(a) Taxability of beneficiary of exempt trust.** Except as otherwise provided in this section, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

#### **(b) Taxability of beneficiary of nonexempt trust.**

**(1) Contributions.** Contributions to an employees' trust made by an employer during a taxable year of the employer which ends with or within a taxable year of the trust for which the trust is not exempt from tax under section 501(a) *shall be included in the gross income of the employee in accordance with section 83* (relating to property transferred in connection with performance of services), except that the value of the employee's interest in the trust shall be substituted for the fair market value of the property for purposes of applying such section.

**(2) Distributions.** The amount actually distributed or made available to any distributee by any trust described in paragraph (1) shall be taxable to the distributee, in the taxable year in which so distributed or made available, under section 72 (relating to annuities), except that distributions of income of such trust before the annuity starting date (as defined in section 72(c)(4)) shall be included in the gross income of the employee without regard to section 72(e)(5) (relating to amounts not received as annuities).

REGULATION: §§ 1.83-3 Meaning and use of certain terms.

**(e) Property.** For purposes of section 83 and the regulations thereunder, the term "property" includes real and personal property other than either money or an unfunded and unsecured promise to pay money or property in the future. *The term also includes a beneficial interest in assets (including money) which are transferred or set aside from the claims of creditors of the transferor, for example, in a trust or escrow account.* See, however, §§ 1.83-8(a) with respect to employee trusts and annuity plans subject to section 402(b) and section 403(c). In the case of a transfer of a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, only the cash surrender value of the contract is considered to be property. Notwithstanding the previous sentence, in the case of a transfer of a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, or any undivided interest therein, that is part of a split-dollar life insurance arrangement (as defined in §§ 1.61-22(b)(1) or (2)) that is entered into, or materially modified (within the meaning of §§ 1.61-22(j)(2)), after September 17, 2003, the policy cash value and all other rights under such contract (including any supplemental agreements thereto and whether or not guaranteed), other than current life insurance protection, are treated as property for purposes of this section. Where rights in a contract providing life insurance protection are substantially nonvested, see §§ 1.83-1(a)(2) for rules relating to taxation of the cost of life insurance protection.

**STATUTE: § 83. Property transferred in connection with performance of services.**

**(a) General rule.** If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

(1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) the amount (if any) paid for such property,

shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

**(b) Election to include in gross income in year of transfer.**

**(1) In general.** Any person who performs services in connection with which property is transferred to any person may *elect to include in his gross income*, for the taxable year in which such property is transferred, the excess of—

(A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over

(B) the amount (if any) paid for such property.

If such election is made, subsection (a) shall not apply with respect to the transfer of such property, *and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.*

**(2) Election.** An election under paragraph (1) with respect to any transfer of property shall be

made in such manner as the Secretary prescribes and shall be made not later than 30 days after the date of such transfer. Such election may not be revoked except with the consent of the Secretary.

**(c) Special rules. For purposes of this section--**

**(1) Substantial risk of forfeiture.** The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

**(2) Transferability of property.** The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

**(3) Sales which may give rise to suit under Section 16(b) of the Securities Exchange Act of 1934.** So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are--

(A) subject to a substantial risk of forfeiture, and

(B) not transferable.

**(d) Certain restrictions which will never lapse.**

**(1) Valuation.** In the case of property subject to a restriction which by its terms will never lapse, and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property unless established to the contrary by the Secretary, and the burden of proof shall be on the Secretary with respect to such value.

**(2) Cancellation.** \*\*\*

**(f) Holding period.** In determining the period for which the taxpayer has held property to which subsection (a) applies, there shall be included only the period beginning at the first time his rights in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

(g) Certain exchanges. \* \* \*

**(h) Deduction by employer.** In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

**Rev. Rul. 60-31; 1960-1 C.B. 174**

**SECTION 451. - GENERAL RULE FOR TAXABLE YEAR OF INCLUSION**

26 CFR 1.451-1: General rule for taxable year of inclusion. (Also Section 404; 1.404(a)-12.)

January, 1960

Discussion of the application of the doctrine of constructive receipt to certain deferred compensation arrangements.

Advice has been requested regarding the taxable year of inclusion in gross income of a taxpayer, using the cash receipts and disbursements method of accounting, of compensation for services received under the circumstances described below.

**FIRST SITUATION**

(1) On January 1, 1958, the taxpayer and corporation X executed an employment contract under which the taxpayer is to be employed by the corporation in an executive capacity for a period of five years. Under the contract, the taxpayer is entitled to a stated annual salary and to additional compensation of 10 x dollars for each year. The additional compensation will be credited to a bookkeeping reserve account and will be deferred, accumulated, and paid in annual installments equal to one-fifth of the amount in the reserve as of the close of the year immediately preceding the year of first payment. The payments are to begin only upon (a) termination of the taxpayer's employment by the corporation; (b) the taxpayer's becoming a part-time employee of the corporation; or (c) the taxpayer's becoming partially or totally incapacitated. Under the terms of the agreement, corporation X is under a merely contractual obligation to make the payments when due, and the parties did not intend that the amounts in the reserve be held by the corporation in trust for the taxpayer.

The contract further provides that if the taxpayer should fail or refuse to perform his duties, the corporation will be relieved of any obligation to make further credits to the reserve (but not of the obligation to distribute amounts previously contributed); but, if the taxpayer should become incapacitated from

performing his duties, then credits to the reserve will continue for one year from the date of the incapacity, but not beyond the expiration of the five-year term of the contract. There is no specific provision in the contract for forfeiture by the taxpayer of his right to distribution from the reserve; and, in the event he should die prior to his receipt in full of the balance in the account, the remaining balance is distributable to his personal representative at the rate of one-fifth per year for five years, beginning three months after his death.

**SECOND SITUATION**

(2) The taxpayer is an officer and director of corporation A, which has a plan for making future payments of additional compensation for current services to certain officers and key employees designated by its board of directors. This plan provides that a percentage of the annual net earnings (before Federal income taxes) in excess of 4,000 x dollars is to be designated for division among the participants in proportion to their respective salaries. This amount is not currently paid to the participants; but, the corporation has set up on its books a separate account for each participant and each year it credits thereto the dollar amount of his participation for the year, reduced by a proportionate part of the corporation's income taxes attributable to the additional compensation. Each account is also credited with the net amount, if any, realized from investing any portion of the amount in the account.

Distributions are to be made from these accounts annually beginning when the employee (1) reaches age 60, (2) is no longer employed by the company, including cessation of employment due to death, or (3) becomes totally disabled to perform his duties, whichever occurs first. The annual distribution will equal a stated percentage of the balance in the employee's account at the close of the year immediately preceding the year of first payment, and distributions will continue until the account is exhausted. However, the corporation's liability to make these distributions is contingent upon the employee's (1) refraining from engaging in any business competitive to that of the corporation, (2) making himself available to the corporation for consultation and advice after retirement or termination of his services, unless disabled, and (3) retaining unencumbered any interest or benefit under the plan.

In the event of his death, either before or after the beginning of payments, amounts in an employee's account are distributable in installments computed in the same way to his designated beneficiaries or heirs-at-law. Under the terms of the compensation plan, corporation A is under a merely contractual obligation to make the payments when due, and the parties did not intend that the amounts in each account be held by the corporation in trust for the participants.

### THIRD SITUATION

(3) On October 1, 1957, the taxpayer, an author, and corporation Y, a publisher, executed an agreement under which the taxpayer granted to the publisher the exclusive right to print, publish and sell a book he had written. This agreement provides that the publisher will (1) pay the author specified royalties based on the actual cash received from the sale of the published work, (2) render semiannual statements of the sales, and (3) at the time of rendering each statement make settlement for the amount due. On the same day, another agreement was signed by the same parties, mutually agreeing that, in consideration of, and notwithstanding any contrary provisions contained in the first contract, the publisher shall not pay the taxpayer more than 100 x dollars in any one calendar year. Under this supplemental contract, sums in excess of 100 x dollars accruing in any one calendar year are to be carried over by the publisher into succeeding accounting periods; and the publisher shall not be required either to pay interest to the taxpayer on any such excess sums or to segregate any such sums in any manner.

### FOURTH SITUATION: ESCROW

(4) In June 1957, the taxpayer, a football player, entered into a two-year standard player's contract with a football club in which he agreed to play football and engage in activities related to football during the two-year term only for the club. In addition to a specified salary for the two-year term, it was mutually agreed that as an inducement for signing the contract the taxpayer would be paid a bonus of 150 x dollars. The taxpayer could have demanded and received payment of this bonus at the time of signing the contract, but at his suggestion there was added to the standard contract form a paragraph providing substantially as follows:

The player shall receive the sum of 150 x dollars upon signing of this contract, contingent upon the payment of this 150 x dollars to an escrow agent designated by him. The escrow agreement shall be subject to approval by the legal representatives of the player, the Club, and the escrow agent.

Pursuant to this added provision, an escrow agreement was executed on June 25, 1957, in which the club agreed to pay 150 x dollars on that date to the Y bank, as escrow agent; and the escrow agent agreed to pay this amount, plus interest, to the taxpayer in installments over a period of five years. The escrow agreement also provides that the account established by the escrow agent is to bear the taxpayer's name; that payments from such account may be made only in accordance with the terms of the agreement; that the agreement is binding upon the parties thereto and their successors or assigns; and that in the event of the taxpayer's death during the escrow period the balance due will become part of his estate.

\* \* \*

Section 1.451-1(a) of the Income Tax Regulations provides in part as follows:

Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. \* \* \*.

And, with respect to the cash receipts and disbursements method of accounting, section 1.446-1(c)(1)(I) provides in part -

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. \* \* \*.

As previously stated, the individual concerned in each of the situations described above, employs the cash receipts and disbursements method of accounting. Under that method, as indicated by the above-quoted provisions of the regulations, he is required to include the compensation concerned in gross income only for the taxable year in which it is actually or constructively received. Consequently, the question for resolution is whether in each of the situations described the income in question was constructively received in a taxable year prior to the taxable year of actual receipt.

**A mere promise to pay, not represented by notes or secured in any way, is not regarded as a receipt of income within the intentment of the cash receipts and disbursements method.** See *United States v. Christine Oil & Gas Co.*, 269 Fed. 458; *William J. Jackson v. Smietanka*, 272 Fed. 970, Ct. D. 5, C.B. 4, 96 (1921); and *E.F. Cremin v. Commissioner*, 5 B.T.A. 1164, acquiescence, C.B. VI-1, 2(1927). Also *C. Florian Zittel v. Commissioner*, 12 B.T.A. 675, in which, holding a salary to be taxable when received, the Board said: "Taxpayers on a receipts and disbursements basis are required to report only income actually received no matter how binding any contracts they may have to receive more."

This should not be construed to mean that under the cash receipts and disbursements method income may be taxed only when realized in cash. For, under that method a taxpayer is required to include in income that which is received in cash or cash equivalent. *W.P. Henritze v. Commissioner*, 41 B.T.A. 505. And, as stated in the above-quoted provisions of the regulations, the "receipt" contemplated by the cash method may be actual or constructive.

With respect to the constructive receipt of income, section 1.4512(a) of the Income Tax Regulations (which accords with prior regulations extending back to, and including, Article 53 of Regulations 45 under

the Revenue Act of 1918) provides, in part, as follows:

Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account or set apart for him so that he may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Thus, if a corporation credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

Thus, under the doctrine of constructive receipt, a taxpayer may not deliberately turn his back upon income and thereby select the year for which he will report it. *The Hamilton National Bank of Chattanooga, as Administrator of the Estate of S. Strang Nicklin, Deceased, v. Commissioner*, 29 B.T.A. 63. Nor may a taxpayer, by a private agreement, postpone receipt of income from one taxable year to another. *James E. Lewis v. Commissioner*, 30 B.T.A. 318.

However, the statute cannot be administered by speculating whether the payor would have been willing to agree to an earlier payment. See, for example, *J.D. Amend, et ux., v. Commissioner*, 13 T.C. 178, acquiescence, C.B. 1950-1, 1; and *C.E. Gullett, et al., v. Commissioner*, 31 B.T.A. 1067, in which the court, citing a number of authorities for its holding, stated:

It is clear that the doctrine of constructive receipt is to be sparingly used; that amounts due from a corporation but unpaid, are not to be included in the income of an individual reporting his income on a cash receipts basis unless it appears that the money was available to him, that the corporation was able and ready to pay him, that his right to receive was not restricted, and that his failure to receive resulted from exercise of his own choice.

Consequently, it seems clear that in each case involving a deferral of compensation a determination of whether the doctrine of constructive receipt is applicable must be made upon the basis of the specific factual situation involved.

Applying the foregoing criteria to the situations described above, the following conclusions have been reached:

**FIRST SITUATION** (1) The additional compensation to be received by the taxpayer under the employment contract concerned will be includible in his gross income only in the taxable years in which the taxpayer actually receives installment payments in cash or other property previously credited to his account. To hold otherwise would be contrary to the provisions of the regulations and the court decisions mentioned above.

**SECOND SITUATION** (2) For the reasons in (1) above, it is held that the taxpayer here involved also will be required to include the deferred compensation concerned in his gross income only in the taxable years in which the taxpayer actually receives installment payments in cash or other property previously credited to his account.

In arriving at this conclusion and the conclusion reached in case "(1)," consideration has been given to section 1.402(b)-1 of the Income Tax Regulations and to Revenue Ruling 57-37, C.B. 1957-1, 18, as modified by Revenue Ruling 57-528, C.B. 1957-2, 263. Section 1.402(b)-1(a)(1) provides in part, with an exception not here relevant, that any contribution made by an employer on behalf of an employee to a trust during a taxable year of the employer which ends within or with a taxable year of the trust for which the trust is not exempt under section 501(a) of the Code, shall be included in income of the employee for his taxable year during which the contribution is made if his interest in the contribution is nonforfeitable at the time the contribution is made. Revenue Ruling 57-37, as modified by Revenue Ruling 57-528, held, *inter alia*, that certain contributions conveying fully vested and nonforfeitable interests made by an employer into separate independently controlled trusts for the purpose of furnishing unemployment and other benefits to its eligible employees constituted additional compensation to the employees includible, under section 402(b) of the Code and section 1.402(b)-1(a) of the regulations, in their income for the taxable year in which such contributions were made. These Revenue Rulings are distinguishable from cases "(1)" and "(2)" in that, under all the facts and circumstances of these cases, no trusts for the benefit of the

taxpayers were created and no contributions are to be made thereto. Consequently, section 402(b) of the Code and section 1.402(b)-1(a)(1) of the regulations are inapplicable.

**THIRD SITUATION** (3) Here the principal agreement provided that the royalties were payable substantially as earned, and this agreement was supplemented by a further concurrent agreement which made the royalties payable over a period of years. This supplemental agreement, however, was made before the royalties were earned; in fact, it was made on the same day as the principal agreement and the two agreements were a part of the same transaction. Thus, for all practical purposes, the arrangement from the beginning is similar to that in (1) above. Therefore, it is also held that the author concerned will be required to include the royalties in his gross income only in the taxable years in which they are actually received in cash or other property.

**FOURTH SITUATION**(4) In arriving at a determination as to the includibility of the 150 x dollars concerned in the gross income of the football player, under the circumstances described, in addition to the authorities cited above, consideration also has been given to Revenue Ruling 55-727, C.B. 1955-2, 25, and to the decision in *E.T. Sproull v. Commissioner*, 16 T.C. 244.

In Revenue Ruling 55-727, the taxpayer, a professional baseball player, entered into a contract in 1953 in which he agreed to render services for a baseball club and to refrain from playing baseball for any other club during the term of the contract. In addition to specified compensation, the contract provided for a bonus to the player or his estate, payable one-half in January 1954 and one-half in January 1955, whether or not he was able to render services. The primary question was whether the bonus was capital gain or ordinary income; and, in holding that the bonus payments constituted ordinary income, it was stated that they were taxable for the year in which received by the player. However, under the facts set forth in Revenue Ruling 55-727 there was no arrangement, as here, for placing the amount of the bonus in escrow. Consequently, the instant situation is distinguishable from that considered in Revenue Ruling 55-727.

In *E.T. Sproull v. Commissioner*, 16 T.C. 244,

affirmed, 194 Fed. (2d) 541, the petitioner's employer in 1945 transferred in trust for the petitioner the amount of \$10,500. The trustee was directed to pay out of principal to the petitioner the sum of \$5,250 in 1946 and the balance, including income, in 1947. In the event of the petitioner's prior death, the amounts were to be paid to his administrator, executor, or heirs. The petitioner contended that the Commissioner erred in including the sum of \$10,500 in his taxable income for 1945. In this connection, the court stated:

\* \* \* it is undoubtedly true that the amount which the Commissioner has included in petitioner's income for 1945 was used in that year for his benefit \* \* \* in setting up the trust of which petitioner, or, in the event of his death then his estate, was the sole beneficiary \* \* \*.

**The question then becomes \* \* \* was "any economic or financial benefit conferred on the employee as compensation" in the taxable year. If so, it was taxable to him in that year. This question we must answer in the affirmative. The employer's part of the transaction terminated in 1945. It was then that the amount of the compensation was fixed at \$10,500 and irrevocably paid out for petitioner's sole benefit. \* \* \*.**

Applying the principles stated in the Sproull decision to the facts here, it is concluded that the 150 x -dollar bonus is includible in the gross income of the football player concerned in 1957, the year in which the club unconditionally paid such amount to the escrow agent.

\* \* \*

As previously stated, in each case involving a deferral of compensation, a determination of whether the doctrine of constructive receipt is applicable must be made upon the basis of the specific factual situation involved.

Consistent with the foregoing, the nonacquiescence published in C.B. 1952-2, 5, with respect to the decision in *Commissioner v. James F. Oates*, 18 T.C. 570, affirmed, 207 Fed. (2d) 711, has been withdrawn and acquiescence substituted therefor at page 5 of this Bulletin.

With respect to deductions for payments made by an employer under a deferred compensation plan, see section 404(a)(5) of the 1954 Code and section 1.404(a)-12 of the Income Tax Regulations.

In the application of those sections to unfunded plans, no deduction is allowable for any compensation paid or accrued by an employer on account of any employee under such a plan except in the year when paid and then only to the extent allowable under section 404(a). Thus, under an unfunded plan, if compensation is paid by an employer directly to a former employee, such amounts are deductible under section 404(a)(5) when actually paid in cash or other property to the employee, provided that such amounts meet the requirements of section 162 or section 212.

## **Sec. 409A. Inclusion in gross income of deferred compensation under nonqualified deferred compensation plans.**

### **(a) Rules relating to constructive receipt.**

#### **(1) Plan failures.**

##### **(A) Gross income inclusion.**

**(i) In general.** If at any time during a taxable year a nonqualified deferred compensation plan--

*(I) fails to meet the requirements of paragraphs (2), (3), and (4), or*

*(II) is not operated in accordance with such requirements,*

**all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income.**

**(ii)** Application only to affected participants. Clause (i) shall only apply with respect to all compensation deferred under the plan for participants with respect to whom the failure relates.

##### **(B) Interest and additional tax payable with respect to previously deferred compensation.**

**(i) In general.** If compensation is required to be included in gross income under subparagraph (A) for a taxable year, the tax imposed by this chapter for the taxable year shall be increased by the sum of--

**(I) the *amount of interest determined under clause (ii), and***

**(II) *an amount equal to 20 percent of the compensation*** which is required to be included in gross income.

**(ii) Interest.** For purposes of clause (i), the interest determined under this clause for any taxable year is the amount of interest at the underpayment rate plus 1 percentage point on the underpayments that would have occurred had the deferred compensation been includible in gross income for the taxable year in which first deferred or, if later, the first taxable year in which such deferred compensation is not subject to a substantial risk of forfeiture.

#### **(2) Distributions.**

**(A) In general.** The requirements of this paragraph are met if the plan provides that compensation deferred under the plan **may not be distributed earlier than--**

**(i) separation from service** as determined by the Secretary (except as provided in subparagraph (B)(i)),

**(ii) the date the participant becomes disabled** (within the meaning of subparagraph (C)),

**(iii) death,**

**(iv) a specified time** (or pursuant to a fixed schedule) **specified under the plan at the date of the deferral of such compensation,**

**(v) to the extent provided by the Secretary,** a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation, or

**(vi) the occurrence of an unforeseeable emergency.**

**(B) Special rules.**

**(i) Specified employees.** In the case of any specified employee, the requirement of subparagraph (A)(i) is met only if distributions may not be made before the date which is **6 months after the date of separation from service** (or, if earlier, the date of death of the employee). For purposes of the preceding sentence, a specified employee is a key employee (as defined in section 416(i) without regard to paragraph (5) thereof) of a corporation any stock in which is publicly traded on an established securities market or otherwise.

**(ii) Unforeseeable emergency.** For purposes of subparagraph (A)(vi)--

**(I) In general.** The term "unforeseeable emergency" means a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent (as defined in section 152(a)) of the participant, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

**(II) Limitation on distributions.** The requirement of subparagraph (A)(vi) is met only if, as determined under regulations of the Secretary, the amounts distributed with respect to an emergency do not exceed the amounts necessary to satisfy such emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

**(C) Disabled.** For purposes of subparagraph (A)(ii), a participant shall be considered disabled if the participant--

(i) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or

(ii) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the participant's employer.

**(3) Acceleration of benefits.** The requirements of this paragraph are met if the plan does not permit the acceleration of the time or schedule of any payment under the plan, except as provided in regulations by the Secretary.

**(4) Elections.**

**(A) In general.** The requirements of this paragraph are met if the requirements of subparagraphs **(B) and (C)** are met.

**(B) Initial deferral decision.**

**(i) In general.** The requirements of this subparagraph are met if the plan provides that compensation for services performed during a taxable year may be deferred at the participant's election only if the election to defer such compensation is made not later than the close of the preceding taxable year or at such other time as provided in regulations.

(ii) First year of eligibility. In the case of the first year in which a participant becomes eligible to participate in the plan, such election may be made with respect to services to be

performed subsequent to the election within 30 days after the date the participant becomes eligible to participate in such plan.

(iii) Performance-based compensation. In the case of any performance-based compensation based on services performed over a period of at least 12 months, such election may be made no later than 6 months before the end of the period.

**(C) Changes in time and form of distribution.** The requirements of this subparagraph are met if, in the case of a plan which permits under a subsequent election a delay in a payment or a change in the form of payment--

(i) the plan requires that such election may not take effect until at least 12 months after the date on which the election is made,

(ii) in the case of an election related to a payment not described in clause (ii), (iii), or (vi) of paragraph (2)(A), the plan requires that the payment with respect to which such election is made be deferred for a period of not less than 5 years from the date such payment would otherwise have been made, and

(iii) the plan requires that any election related to a payment described in paragraph (2)(A)(iv) may not be made less than 12 months prior to the date of the first scheduled payment under such paragraph.

**(b) Rules relating to funding.**

**(1) Offshore property in a trust.** \* \* \*

**(2) Employer's financial health.** In the case of compensation deferred under a nonqualified deferred compensation plan, there is a transfer of property within the meaning of section 83 with respect to such compensation as of the earlier of--

(A) the date on which the plan first provides that assets will become restricted to the provision of benefits under the plan in connection with a change in the employer's financial health, or

(B) the date on which assets are so restricted,  
whether or not such assets are available to satisfy claims of general creditors.

**(3) Income inclusion for offshore trusts and employer's financial health.** For each taxable year that assets treated as transferred under this subsection remain set aside in a trust or other arrangement subject to paragraph (1) or (2), any increase in value in, or earnings with respect to, such assets shall be treated as an additional transfer of property under this subsection (to the extent not previously included in income).

**(4) Interest on tax liability payable with respect to transferred property.**

(A) In general. If amounts are required to be included in gross income by reason of paragraph (1) or (2) for a taxable year, the tax imposed by this chapter for such taxable year shall be increased by the sum of

(i) the amount of interest determined under subparagraph (B), and

(ii) an amount equal to 20 percent of the amounts required to be included in gross income.

**(B) Interest.** \* \* \*

**(c) No inference on earlier income inclusion or requirement of later inclusion.** Nothing in this section shall be construed to prevent the inclusion of amounts in gross income under any other provision of this chapter or any other rule of law earlier than the time provided in this

section. Any amount included in gross income under this section shall not be required to be included in gross income under any other provision of this chapter or any other rule of law later than the time provided in this section.

**(d) Other definitions and special rules.** For purposes of this section:

(1) Nonqualified deferred compensation plan. The term "nonqualified deferred compensation plan" means any plan that provides for the deferral of compensation, other than--

(A) a qualified employer plan, and

(B) any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan.

(2) Qualified employer plan. The term "qualified employer plan" means--

(A) any plan, contract, pension, account, or trust described in subparagraph (A) or (B) of section 219(g)(5)(without regard to subparagraph (A)(iii)),

(B) any eligible deferred compensation plan (within the meaning of section 457(b)), and

(C) any plan described in section 415(m).

(3) Plan includes arrangements, etc. The term "plan" includes any agreement or arrangement, including an agreement or arrangement that includes one person.

(4) **Substantial risk of forfeiture.** The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual.

(5) Treatment of earnings. References to deferred compensation shall be treated as including references to income (whether actual or notional) attributable to such compensation or such income.

(6) Aggregation rules. Except as provided by the Secretary, rules similar to the rules of subsections (b) and (c) of section 414 shall apply.

(e) Regulations.

## **PROBLEMS: NONQUALIFIED DEFERRED COMPENSATION ARRANGEMENTS**

Ms. Executive is contemplating entering into one of several deferred compensation agreements with The Corporation, Inc., a corporation owned by 10 individuals. She has a five year employment agreement, but very few people who have held the position she will have, stayed with the business that long. The Corporation has barely made a profit over the last 3 years.

The Corporation will pay her \$80,000 per year and will defer an additional \$40,000 per year until she terminates her employment. The Corporation will also pay interest computed at 15% on the deferred amount. If she stays for the full five years the accumulated amount would be approximately \$270,000 and she would then begin to receive annual distributions (plus interest) amortized over her life expectancy.

- I. Determine when she will recognize taxable income from the (a) deferred compensation and (b) the interest, and when the Corporation will be entitled to claim deductions for those items.
  - a. The Corporation will pay the amount when she terminates her employment; no separate account or trust will be established.
  - b. The Corporation will establish an account on its books and will record the deferred amounts and the accrued interest at the end of each year.
  - c. The Corporation will establish an escrow account at a bank for the benefit of Ms. Executive which cannot be attached by creditors of Ms. Executive or of the Corporation. Each year it will deposit \$40,000 and, if the accumulated interest is insufficient when Ms. Executive terminates her employment, the corporation will contribute the shortfall at that time. (If there is a surplus, it will be returned to the Corporation). Amounts will not be made available to Ms. Executive until she terminates her employment, at which time the bank will purchase an annuity to make payments over her life expectancy.
  - d. The Corporation will establish a trust at a local bank and will name itself as the Grantor as well as the Beneficiary. Under the terms of the agreement, the Corporation will contribute \$40,000 each year to the trust plus sufficient additional amounts to assure a 15% return. The entire balance in the trust will be used to purchase an annuity for Ms. Executive when she terminates her employment. No amount will be made available to Ms. Executive until she terminates her employment. The assets in the trust could be subject to attached by judgement creditors of the Corporation.
- II. As Ms. Executive's attorney, which of these agreements would you recommend after balancing tax and other considerations?

### **B. I.R.C. §83 - Compensation in the form of property**

- I. On November 1, 1998, Genetech sold to Mr. Gen, an employee, 100 shares of its stock at a price of \$10 per share. At the time of the sale, the fair market value of the stock was \$100 per share. Under the terms of the sale each share of stock was subject to a substantial risk of forfeiture which would not lapse until November 1, 2008. Evidence of this restriction was stamped on the face of Mr. Gen's stock certificates so that they were not transferable. The stock increased in value to

\$200 per share on November 1, 2004, to \$230 per share on November 1, 2005, and to \$260 per share on November 1, 2008. Mr. Gen received a \$150 dividend on November 1, 1999.

- 1) How much income will Mr. Gen report as compensation in 1998 from this transaction?
  - 2) Is the payment of dividends considered compensation by the corporation so that it can be deducted (dividend are usually not deductible by a corporation)?
  - 3) How much income will Mr. Gen report in 2008 when the stock becomes substantially vested?
  - 4) Assume in the above facts that effective November 1, 2005, Mr. Gen could as a matter of law transfer to a bona fide purchaser each share of stock and that purchaser would not have to forfeit the stock if Mr. Gen quit the corporation (the substantial risk of forfeiture). If Mr. Gen quit he would be liable for damages to the corporation rather than a forfeiture. Would these facts cause Mr.. Gen to recognize income in 2005 and, if so, how much? If he recognizes the income in 2005 how much income would he recognize in 2008?
  - 5) Assume that on November 1, 2004 Mr. Gen sold his 100 shares of stock in an arms length sale to RELAXED BROTHERS, an investment company, for \$120 per share. How much money would Mr.. Gen have to report as income and would it be considered compensation or capital gain?
- C. On March 1, 2001, Marriott Legal Services Corporation gave to Ms. Lawyer, in connection with her performance of services to the corporation, a bonus of 100 shares of corporate stock. Under the terms of the bonus arrangement Ms. Lawyer was obligated to return the stock to the corporation if she terminated her employment for any reason. However, for each year after March 1, 2001, during which she remained employed with the corporation, the corporation agreed to pay, in a redemption of the bonus shares given to her, 10% of the fair market value of each share of stock on the date of such termination of employment. Thus, after 10 years of service she would be entitled to receive full fair market value of the stock.

The stock had the following values on March 1st of each of the following years:

<b>Date</b>	<b>Fair market value of all 100 shares of stock</b>
2002	\$4,000.00
2003	6,000.00
2004	3,000.00
2005	3,000.00
2006	2,000.00

Ms. Lawyer terminated her employment on February 1, 2007, when the fair market value of all 100 shares of bonus stock was \$2,000.00.

Calculate the following:

1. What amount of income did Ms. Lawyer have to recognize in 2001, 2002, 2003, 2004, 2005 and/or 2007?

2. What was Ms. Lawyer's basis in her stock and did she have a long term or short term capital gains/loss?

### III. CONTRIBUTIONS TO IRAs.

Jane and Tom Doe file a joint return for calendar year 2004. They wish to contribute the maximum possible amount to an IRA.

- A. Can they establish a joint IRA or do they have to establish separate IRAs?
- B. Assume their adjusted gross income is \$70,000. How much can they (1) contribute and (2) deduct under the following circumstances?
  1. Neither of them is covered by a qualified retirement plan and each of them has earned income of \$35,000.
  2. Neither of them is covered by a qualified retirement plan and Jane has earned income of \$70,000 and Tom has earned income of only \$200.
  3. Only Tom is covered by a qualified retirement plan and each of them has earned income of 35,000.
  4. Both are covered by qualified retirement plans and each of them has earned income of \$35,000.