

§ 71. Alimony and separate maintenance payments.

(a) **General rule.** Gross income includes amounts received as alimony or separate maintenance payments.

[[§ 215. Alimony, etc., payments.

(a) **General rule.** In the case of an individual, there shall be allowed as a deduction an amount equal to the alimony or separate maintenance payments paid during such individual's taxable year.

(b) **Alimony or separate maintenance payments defined.** For purposes of this section, the term "alimony or separate maintenance payment" means any alimony or separate maintenance payment (as defined in section 71(b)) which is includible in the gross income of the recipient under section 71.

(c) **Requirement of identification number.** The Secretary may prescribe regulations under which--

- (1) any individual receiving alimony or separate maintenance payments is required to furnish such individual's taxpayer identification number to the individual making such payments, and
- (2) the individual making such payments is required to include such taxpayer identification number on such individual's return for the taxable year in which such payments are made.

(d) **Coordination with section 682.** No deduction shall be allowed under this section with respect to any payment if, by reason of section 682 (relating to income of alimony trusts), the amount thereof is not includible in such individual's gross income.]]

§ 71. Alimony and separate maintenance payments.

(a) **General rule.** Gross income includes amounts received as alimony or separate maintenance payments.

(b) **Alimony or separate maintenance payments defined.** For purposes of this section--

(1) **In general.** The term "alimony or separate maintenance payment" means any payment in *cash* if--

(A) such payment is received by (or on behalf of) a spouse under a *divorce or separation instrument*,

(B) the divorce or separation instrument does not designate such payment as a payment which is not includible in gross income under this section and not allowable as a deduction under section 215,

(C) in the case of an individual legally separated from his spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and

(D) there is no liability to make any such payment for any period after the death of the payee

spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse.

(2) Divorce or separation instrument. The term "divorce or separation instrument" means--

- (A) a decree of divorce or separate maintenance or a *written* instrument incident to such a decree,
- (B) a *written* separation agreement, or
- (C) a decree (not described in subparagraph (A)) requiring a spouse to make payments for the support or maintenance of the other spouse.

(c) Payments to support children.

(1) In general. Subsection (a) shall not apply to that part of any payment which the terms of the divorce or separation instrument *fix* (in terms of an amount of money or a part of the payment) as a sum which is payable for the support of children of the payor spouse.

(2) Treatment of certain reductions related to contingencies involving child. For purposes of paragraph (1), if any amount specified in the instrument will be reduced--

- (A) on the happening of a contingency specified in the instrument relating to a child (such as attaining a specified age, marrying, dying, leaving school, or a similar contingency), or
- (B) at a time which can clearly be associated with a contingency of a kind specified in subparagraph (A),

an amount equal to the amount of such reduction will be treated as an amount *fixed* as payable for the support of children of the payor spouse.

(3) Special rule where payment is less than amount specified in instrument. For purposes of this subsection, if any payment is less than the amount specified in the instrument, then so much of such payment as does not exceed the sum payable for support shall be considered a payment for such support.

(d) Spouse. For purposes of this section, the term "spouse" includes a former spouse.

(e) Exception for joint returns. This section and section 215 shall not apply if the spouses make a joint return with each other.

(f) Recomputation where excess front-loading of alimony payments.

(1) In general. If there are excess alimony payments--

(A) the payor spouse shall include the amount of such excess payments in gross income for the payor spouse's taxable year beginning in the 3rd post-separation year, and

(B) the payee spouse shall be allowed a deduction in computing adjusted gross income for the amount of such excess payments for the payee's taxable year beginning in the 3rd post-separation year.

(2) Excess alimony payments. For purposes of this subsection, the term "excess alimony payments" mean the sum of--

(A) the excess payments for the 1st post-separation year, and

(B) the excess payments for the 2nd post-separation year.

(3) Excess payments for 1st post-separation year. For purposes of this subsection, the amount of the excess payments for the 1st post-separation year is the excess (if any) of--

(A) the amount of the alimony or separate maintenance payments paid by the payor spouse

during the 1st post-separation year, over

(B) the sum of--

(i) the average of--

(I) the alimony or separate maintenance payments paid by the payor spouse during the 2nd post-separation year, reduced by the excess payments for the 2nd post-separation year, and (II) the alimony or separate maintenance payments paid by the payor spouse during the 3rd post-separation year, plus

(ii) \$ 15,000.

(4) Excess payments for 2nd post-separation year. For purposes of this subsection, the amount of the excess payments for the 2nd post-separation year is the excess (if any) of--

(A) the amount of the alimony or separate maintenance payments paid by the payor spouse during the 2nd post-separation year, over

(B) the sum of--

(i) the amount of the alimony or separate maintenance payments paid by the payor spouse during the 3rd post-separation year, plus

(ii) \$ 15,000.

(5) Exceptions.

(A) Where payment ceases by reason of death or remarriage. Paragraph (1) shall not apply if--

(i) either spouse dies before the close of the 3rd post-separation year, or the payee spouse remarries before the close of the 3rd post-separation year, and

(ii) the alimony or separate maintenance payments cease by reason of such death or remarriage.

(B) Support payments. For purposes of this subsection, the term "alimony or separate maintenance payment" shall not include any payment received under a decree described in subsection (b)(2)(C).

(C) Fluctuating payments not within control of payor spouse. For purposes of this subsection, the term "alimony or separate maintenance payment" shall not include any payment to the extent it is made pursuant to a continuing liability (over a period of not less than 3 years) to pay a fixed portion or portions of the income from a business or property or from compensation for employment or self-employment.

(6) Post-separation years. For purposes of this subsection, the term "1st post-separation years" means the 1st calendar year in which the payor spouse paid to the payee spouse alimony or separate maintenance payments to which this section applies. The 2nd and 3rd post-separation years shall be the 1st and 2nd succeeding calendar years, respectively.

§ 101. Certain death benefits.

(a) Proceeds of life insurance contracts payable by reason of death.

(1) General rule. Except as otherwise provided in paragraph (2), subsection (d), and subsection (f), gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured.

(2) Transfer for valuable consideration. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from gross income by paragraph (1) shall not exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid by the transferee. The preceding sentence shall not apply in the case of such a transfer--

(A) if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest

therein in the hands of the transferor, or
(B) if such transfer is to
the insured,
to a partner of the insured,
to a partnership in which the insured is a partner,
or to a corporation in which the insured is a shareholder or officer.

The term "other amounts" in the first sentence of this paragraph includes interest paid or accrued by the transferee on indebtedness with respect to such contract or any interest therein if such interest paid or accrued is not allowable as a deduction by reason of section 264(a)(4).

(b) Repealed.

(c) Interest. If any amount excluded from gross income by subsection (a) is held under an agreement to pay interest thereon, the interest payments shall be included in gross income.

(d) Payment of life insurance proceeds at a date later than death.

(1) General rule. The amounts held by an insurer with respect to any beneficiary shall be prorated (in accordance with such regulations as may be prescribed by the Secretary) over the period or periods with respect to which such payments are to be made. There shall be excluded from the gross income of such beneficiary in the taxable year received any amount determined by such proration. Gross income includes, to the extent not excluded by the preceding sentence, amounts received under agreements to which this subsection applies.

(2) Amount held by an insurer. An amount held by an insurer with respect to any beneficiary shall mean an amount to which subsection (a) applies which is--

(A) held by any insurer under an agreement provided for in the life insurance contract, whether as an option or otherwise, to pay such amount on a date or dates later than the death of the insured, and

(B) equal to the value of such agreement to such beneficiary

(i) as of the date of death of the insured (as if any option exercised under the life insurance contract were exercised at such time), and

(ii) as discounted on the basis of the interest rate used by the insurer in calculating payments under the agreement and mortality tables prescribed by the Secretary.

(3) Application of subsection. This subsection shall not apply to any amount to which subsection (c) is applicable.

(e) Repealed.

(f) Proceeds of flexible premium contracts issued before January 1, 1985 payable by reason of death.

(g) Treatment of certain accelerated death benefits.

(1) In general. For purposes of this section, the following amounts shall be treated as an amount paid by reason of the death of an insured:

(A) Any amount received under a life insurance contract on the life of an insured who is a

terminally ill individual.

(B) Any amount received under a life insurance contract on the life of an insured who is a chronically ill individual.

(2) Treatment of viatical settlements.

(A) In general. If any portion of the death benefit under a life insurance contract on the life of an insured described in paragraph (1) is sold or assigned to a viatical settlement provider, the amount paid for the sale or assignment of such portion shall be treated as an amount paid under the life insurance contract by reason of the death of such insured.

(B) Viatical settlement provider.

(i) In general. The term "viatical settlement provider" means any person regularly engaged in the trade or business of purchasing, or taking assignments of, life insurance contracts on the lives of insureds described in paragraph (1) if--

(I) such person is licensed for such purposes (with respect to insureds

PART III. ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

IRC Sec. 102 (2004)

§ 102. Gifts and inheritances.

(a) General rule. Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

(b) Income. Subsection (a) shall not exclude from gross income--

(1) the income from any property referred to in subsection (a); or

(2) where the gift, bequest, devise, or inheritance is of income from property, the amount of such income.

Where, under the terms of the gift, bequest, devise, or inheritance, the payment, crediting, or distribution thereof is to be made at intervals, then, to the extent that it is paid or credited or to be distributed out of income from property, it shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property. Any amount included in the gross income of a beneficiary under subchapter J shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property.

(c) Employee Gifts.

(1) In general. Subsection (a) shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee.

(2) Cross references. For provisions excluding certain employee achievement awards from gross income, see section 74(c).

For provisions excluding certain de minimis fringes from gross income, see section 132(e).

§ 104. Compensation for injuries or sickness.

(a) **In general.** Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include--

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of *any damages* (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of *personal physical injuries or physical sickness*;

(3) amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer);

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 808 of the Foreign Service Act of 1980; and

(5) amounts received by an individual as disability income attributable to injuries incurred as a direct result of a *terroristic or military action* (as defined in section 692(c)(2)).

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee. ***For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness.*** The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress.

§ 132. Certain fringe benefits.

(a) **Exclusion from gross income.** Gross income shall not include any fringe benefit which qualifies as a--

- (1) no-additional-cost service,
- (2) qualified employee discount,
- (3) working condition fringe,
- (4) de minimis fringe,
- (5) qualified transportation fringe,
- (6) qualified moving expense reimbursement,
- (7) qualified retirement planning services, or
- (8) qualified military base realignment and closure fringe.

(b) No-additional-cost service defined. For purposes of this section, the term "no-additional-cost service" means any service provided by an employer to an employee for use by such employee if--

- (1) such *service* is offered for sale to customers in the ordinary course of the *line of business* of the employer in which the employee is performing services, **and**
- (2) the *employer incurs no substantial additional cost (including forgone revenue) in providing such service to the employee* (determined without regard to any amount paid by the employee for such service).

(c) Qualified employee discount defined. For purposes of this section--

(1) Qualified employee discount. The term "qualified employee discount" means any employee discount with respect to qualified property or services to the extent such discount does not exceed--

(A) *in the case of property, the gross profit percentage of the price at which the property is being offered by the employer to customers, or*

(B) in the case of services, 20 percent of the price at which the services are being offered by the employer to customers.

(2) Gross profit percentage.

(A) In general. The term "gross profit percentage" means the percent which--

(i) the excess of the aggregate sales price of property sold by the employer to customers over the aggregate cost of such property to the employer, is of

(ii) the aggregate sale price of such property.

(B) Determination of gross profit percentage. Gross profit percentage shall be determined on the basis of--

(i) all property offered to customers in the ordinary course of the line of business of the employer in which the employee is performing services (or a reasonable classification of property selected by the employer), and

(ii) the employer's experience during a representative period.

(3) Employee discount defined. The term "employee discount" means the amount by which--

(A) the price at which the property or services are provided by the employer to an employee for use by such employee, is less than

(B) the price at which such property or services are being offered by the employer to customers.

(4) Qualified property or services. The term "qualified property or services" means any property (other than real property and other than personal property of a kind held for investment) or services which are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services.

(d) Working condition fringe defined. For purposes of this section, the term "working condition fringe" means any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under section 162 or 167.

(e) De minimis fringe defined. For purposes of this section--

(1) In general. The term "de minimis fringe" means any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable.

(2) Treatment of certain eating facilities. The operation by an employer of any eating facility for employees shall be treated as a de minimis fringe if--

(A) such facility is located on or near the business premises of the employer, and

(B) revenue derived from such facility normally equals or exceeds the direct operating costs of such facility.

The preceding sentence shall apply with respect to any highly compensated employee only if access to the facility is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees. For purposes of subparagraph (B), an employee entitled under section 119 to exclude the value of a meal provided at such facility shall be treated as having paid an amount for such meal equal to the direct operating costs of the facility attributable to such meal.

(f) Qualified transportation fringe.

(1) **In general.** For purposes of this section, the term "qualified transportation fringe" means any of the following provided by an employer to an employee:

(A) *Transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment.*

(B) *Any transit pass. [max tax-free \$100 / month]*

(C) *Qualified parking. [max tax-free \$195/month]*

(4) **No constructive receipt.** No amount shall be included in the gross income of an employee solely because the employee may choose between any qualified transportation fringe and compensation which would otherwise be includible in gross income of such employee.

(5) **Definitions.** For purposes of this subsection--

(A) *Transit pass.* The term "transit pass" means any pass, token, farecard, voucher, or similar item entitling a person to transportation (or transportation at a reduced price) if such transportation is--

(i) on mass transit facilities (whether or not publicly owned), or

(ii) provided by any person in the business of transporting persons for compensation or hire if such transportation is provided in a vehicle meeting the requirements of subparagraph (B)(i).

(B) *Commuter highway vehicle.* The term "commuter highway vehicle" means any highway vehicle--

(i) the seating capacity of which is at least 6 adults (not including the driver), and

(ii) at least 80 percent of the mileage use of which can reasonably be expected to be-- * * *

(g) Qualified moving expense reimbursement. For purposes of this section, the term "qualified

moving expense reimbursement" means any amount received (directly or indirectly) by an individual from an employer as a payment for (or a reimbursement of) expenses which would be deductible as moving expenses under section 217 if directly paid or incurred by the individual. Such term shall not include any payment for (or reimbursement of) an expense actually deducted by the individual in a prior taxable year.

(h) Certain individuals treated as employees for purposes of subsections (a)(1) and (2). For purposes of paragraphs (1) and (2) of subsection (a)--

(1) Retired and disabled employees and surviving spouse of employee treated as employee.

With respect to a line of business of an employer, the term "employee" includes-- * **/

(i) Reciprocal agreements. * * *

(j) Special rules.

(1) Exclusions under subsection (a)(1) and (2) apply to highly compensated employees only if no discrimination. Paragraphs (1) and (2) of subsection (a) shall apply with respect to any fringe benefit described therein provided with respect to any highly compensated employee only if such fringe benefit is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of highly compensated employees.

(2) Special rule for leased sections of department stores. * *

(3) Auto salesmen. * * *

(4) On-premises gyms and other athletic facilities.

(A) In general. Gross income shall not include the value of any on-premises athletic facility provided by an employer to his employees.

(B) On-premises athletic facility. For purposes of this paragraph, the term "on-premises athletic facility" means any gym or other athletic facility--

(i) which is located on the premises of the employer,

(ii) which is operated by the employer, and

(iii) substantially all the use of which is by employees of the employer, their spouses, and their dependent children (within the meaning of subsection (h)).

(5) Special rule for affiliates of airlines.

(A) In general. If--

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§ 162. Trade or business expenses.

(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. . . .

(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.

(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, or customer.

(d) Capital contributions to Federal National Mortgage Association. * * *

(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
 - (D) any direct communication with a covered executive branch official in an attempt to influence the official actions or positions of such official.
- (2) Exception for local legislation.** In the case of any legislation of any local council or similar governing body--
- (A) paragraph (1)(A) shall not apply, and * *

§ 1.162-5 Expenses for education.

Example (1). A, a self-employed individual practicing a profession other than law, for example, engineering, accounting, etc., attends law school at night and after completing his law school studies receives a bachelor of laws degree. The expenditures made by A in attending law school are nondeductible because this course of study qualifies him for a new trade or business.

Example (2). Assume the same facts as in example (1) except that A has the status of an employee rather than a self-employed individual, and that his employer requires him to obtain a bachelor of laws degree. A intends to continue practicing his nonlegal profession as an employee of such employer. Nevertheless, the expenditures made by A in attending law school are not deductible since this course of study qualifies him for a new trade or business.

§ 212. Expenses for production of income.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year--

- (1) for the production or collection of income;
- (2) for the management, conservation, or maintenance of property held for the production of income; or
- (3) in connection with the determination, collection, or refund of *any tax*.

§ 262. Personal, living, and family expenses.

(a) General rule. *Except* as otherwise expressly provided in this chapter, *no deduction* shall be allowed for personal, living, or family expenses.

(b) Treatment of certain phone expenses. For purposes of subsection (a), in the case of an individual, any charge (including taxes thereon) for basic local telephone service with respect to

the 1st telephone line provided to any residence of the taxpayer shall be treated as a personal expense.

183. Activities not engaged in for profit.

(a) General rule. In the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) Deductions allowable. In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed--

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

(c) Activity not engaged in for profit defined. For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212.

(d) Presumption. If the *gross income derived from an activity for 3 or more of the taxable years in the period of 5 consecutive taxable years ... exceeds the deductions attributable to such activity* (determined without regard to whether or not such activity is engaged in for profit), then, unless the Secretary establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit. In the case of an activity which consists in major part of the breeding, training, showing, or racing of *horses*, the preceding sentence shall be applied by substituting "2" for "3" and "7" for "5".

§ 162. Trade or business expenses.

(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. . . .

(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.

(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, or customer.

(d) Capital contributions to Federal National Mortgage Association. * * *

(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

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

(2) Exception for local legislation. In the case of any legislation of any local council or similar governing body--

(A) paragraph (1)(A) shall not apply, and * *

§ 1.162-5 Expenses for education.

Example (1). A, a self-employed individual practicing a profession other than law, for example, engineering, accounting, etc., attends law school at night and after completing his law school studies receives a bachelor of laws degree. The expenditures made by A in attending law school are nondeductible because this course of study qualifies him for a new trade or business.

Example (2). Assume the same facts as in example (1) except that A has the status of an employee rather than a self-employed individual, and that his employer requires him to obtain a bachelor of laws degree. A intends to continue practicing his nonlegal profession as an employee of such employer. Nevertheless, the expenditures made by A in attending law school are not deductible since this course of study qualifies him for a new trade or business.

§ 212. Expenses for production of income.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year--

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of *any tax*.

§ 262. Personal, living, and family expenses.

(a) General rule. *Except* as otherwise expressly provided in this chapter, *no deduction* shall be allowed for personal, living, or family expenses.

(b) Treatment of certain phone expenses. For purposes of subsection (a), in the case of an individual, any charge (including taxes thereon) for basic local telephone service with respect to the 1st telephone line provided to any residence of the taxpayer shall be treated as a personal expense.

183. Activities not engaged in for profit.

(a) General rule. In the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

(b) Deductions allowable. In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed--

(1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1).

(c) Activity not engaged in for profit defined. For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under section 162 or under paragraph (1) or (2) of section 212.

(d) Presumption. If the *gross income derived from an activity for 3 or more of the taxable years in the period of 5 consecutive taxable years ... exceeds the deductions attributable to such activity* (determined without regard to whether or not such activity is engaged in for profit), then, unless the Secretary establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit. In the case of an activity which consists in major part of the breeding, training, showing, or racing of *horses*, the preceding sentence shall be applied by substituting "2" for "3" and "7" for "5".

§ 267. Losses, expenses, and interest with respect to transactions between related taxpayers.

(a) In general.

(1) Deduction for losses disallowed. No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.

(2) Matching of deduction and payee income item in the case of expenses and interest. If--

(A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person [*translation: recipient is on cash method*], and

(B) at the close of the taxable year of the taxpayer for which (but for this paragraph) the amount would be deductible under this chapter, both the taxpayer and the person to whom the payment is to be made are persons specified in any of the paragraphs of subsection (b) [*translation: payor and recipient are "related parties"*]

then **any deduction** allowable under this chapter in respect of such amount shall be allowable **as of the day as of which such amount is includible in the gross income of the person to whom the payment is made** (or, if later, as of the day on which it would be so allowable but for this paragraph). For purposes of this paragraph, in the case of a personal service corporation (within the meaning of section 441(i)(2)), such corporation and any employee-owner (within the meaning of section 269A(b)(2), as modified by section 441(i)(2)) shall be treated as persons specified in subsection (b).

(3) Payments to foreign persons. The Secretary shall by regulations apply the matching principle of paragraph (2) in cases in which the person to whom the payment is to be made is not a United States person.

(b) Relationships. The persons referred to in subsection (a) are:

(1) Members of a family, as defined in subsection (c)(4);

(2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(3) Two corporations which are members of the same controlled group (as defined in subsection (f));

(4) A grantor and a fiduciary of any trust;

(5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;

(6) A fiduciary of a trust and a beneficiary of such trust;

(7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

(8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;

(9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;

(10) A corporation and a partnership if the same persons own--

(A) more than 50 percent in value of the outstanding stock of the corporation, and

(B) more than 50 percent of the capital interest, or the profits interest, in the partnership;

(11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;

(12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or

(13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an **executor**

of an estate and a beneficiary of such estate.

(c) Constructive ownership of stock. For purposes of determining, in applying subsection (b), the ownership of stock--

(1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(3) An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1), (2), or (3), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

(d) Amount of gain where loss previously disallowed. If--

(1) in the case of a sale or exchange of property to the taxpayer a loss sustained by the transferor is not allowable to the transferor as a deduction by reason of subsection (a)(1) (or by reason of section 24(b) of the Internal Revenue Code of 1939); and

(2) after December 31, 1953, the taxpayer sells or otherwise disposes of such property (or of other property the basis of which in his hands is determined directly or indirectly by reference to such property) at a gain,

then such gain shall be recognized only to the extent that it exceeds so much of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer. This subsection applies with respect to taxable years ending after December 31, 1953. This subsection shall not apply if the loss sustained by the transferor is not allowable to the transferor as a deduction by reason of section 1091 (relating to wash sales) or by reason of section 118 of the Internal Revenue Code of 1939.

§ 291. Special rules relating to corporate preference items.

(a) Reduction in certain preference items, etc. For purposes of this subtitle, in the case of a corporation--

(1) Section 1250 capital gain treatment. in the case of section *1250 property [usually buildings]* which is disposed of during the taxable year, **20 percent of the excess (if any) of--**

(A) the amount which would be treated as ordinary income if such property was section 1245 property, over

(B) the amount treated as ordinary income under section 1250 (determined without regard to this paragraph), **shall be treated as gain which is ordinary income** under section 1250 and shall be

recognized notwithstanding any other provision of this title.

Under regulations prescribed by the Secretary, the provisions of this paragraph shall not apply to the disposition of any property to the extent section 1250(a) does not apply to such disposition by reason of section 1250(d).

§ 274. Disallowance of certain entertainment, etc., expenses.

(a) Entertainment, amusement, or recreation.

(1) In general. No deduction otherwise allowable under this chapter shall be allowed for any item--

(A) Activity. With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, unless the taxpayer establishes that the item was directly related to, or, in the case of an item directly preceding or following a substantial and bona fide business discussion (including business meetings at a convention or otherwise), that such item was associated with, the active conduct of the taxpayer's trade or business, or

(B) Facility. With respect to a facility used in connection with an activity referred to in subparagraph (A).

In the case of an item described in subparagraph (A), the deduction shall in no event exceed the portion of such item which meets the requirements of subparagraph (A).

(2) Special rules. For purposes of applying paragraph (1)--

(A) Dues or fees to any social, athletic, or sporting club or organization shall be treated as items with respect to facilities.

(B) An activity described in section 212 shall be treated as a trade or business.

(C) In the case of a club, paragraph (1)(B) shall apply unless the taxpayer establishes that the facility was used primarily for the furtherance of the taxpayer's trade or business and that the item was directly related to the active conduct of such trade or business.(3) Denial of deduction for club dues. Notwithstanding the preceding provisions of this subsection, no deduction shall be allowed under this chapter for amounts paid or incurred for membership in any club organized for business, pleasure, recreation, or other social purpose.

(b) Gifts.

(1) **Limitation.** No deduction shall be allowed under section 162 or section 212 for any expense for gifts made directly or indirectly to any individual to the extent that such expense, when added to prior expenses of the taxpayer for gifts made to such individual during the same taxable year, **exceeds \$ 25.** For purposes of this section, the term "gift" means any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision of this chapter, but such term does not include--

(A) an item having a cost to the taxpayer not in excess of \$ 4.00 on which the name of the taxpayer is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the taxpayer, or

(B) a sign, display rack, or other promotional material to be used on the business premises of the recipient.

(2) Special rules.

(A) In the case of a gift by a partnership, the limitation contained in paragraph (1) shall apply to the partnership as well as to each member thereof.

(B) For purposes of paragraph (1), a husband and wife shall be treated as one taxpayer.

(c) Certain foreign travel.

(1) In general. In the case of any individual who travels outside the United States away from home in pursuit of a trade or business or in pursuit of an activity described in section 212, no deduction shall be allowed under section 162 or section 212 for that portion of the expenses of such travel otherwise allowable under such section which, under regulations prescribed by the Secretary, is not allocable to such trade or business or to such activity.

(2) Exception. Paragraph (1) shall not apply to the expenses of any travel outside the United States away from home if--

(A) such travel does not exceed one week, or

(B) the portion of the time of travel outside the United States away from home which is not attributable to the pursuit of the taxpayer's trade or business or an activity described in section 212 is less than 25 percent of the total time on such travel.

(3) Domestic travel excluded. For purposes of this subsection, travel outside the United States does not include any travel from one point in the United States to another point in the United States.

(d) Substantiation required. No deduction or credit shall be allowed--

(1) under section 162 or 212 for any traveling expense (including meals and lodging while away from home),

(2) for any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such an activity,

(3) for any expense for gifts, or

(4) with respect to any listed property (as defined in section 280F(d)(4)),

unless the taxpayer substantiates by **adequate records or by sufficient evidence corroborating the taxpayer's own statement**

(A) the amount of such expense or other item,

(B) the time and place of the travel, entertainment, amusement, recreation, or use of the facility or property, or the date and description of the gift,

(C) the business purpose of the expense or other item, and

(D) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift.

The Secretary may by regulations provide that some or all of the requirements of the preceding sentence shall not apply in the case of an expense which does not exceed an amount prescribed pursuant to such regulations. This subsection shall not apply to any qualified nonpersonal use

vehicle (as defined in subsection (i)).

(e) Specific exceptions to application of subsection (a). Subsection (a) shall not apply to--

(1) Food and beverages for employees. Expenses for food and beverages (and facilities used in connection therewith) furnished on the business premises of the taxpayer primarily for his employees.

(2) Expenses treated as compensation. Expenses for goods, services, and facilities, to the extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, amusement, or recreation, as compensation to an employee on the taxpayer's return of tax under this chapter and as wages to such employee for purposes of chapter 24 (relating to withholding of income tax at source on wages).

(3) Reimbursed expenses. Expenses paid or incurred by the taxpayer, in connection with the performance by him of services for another person (whether or not such other person is his employer), under a reimbursement or other expense allowance arrangement with such other person, but this paragraph shall apply--

(A) where the services are performed for an employer, only if the employer has not treated such expenses in the manner provided in paragraph (2), or

(B) where the services are performed for a person other than an employer, only if the taxpayer accounts (to the extent provided by subsection (d)) to such person.

(4) Recreational, etc., expenses for employees. Expenses for recreational, social, or similar activities (including facilities therefor) primarily for the benefit of employees (other than employees who are highly compensated employees (within the meaning of section 414(q))). For purposes of this paragraph, an individual owning less than a 10-percent interest in the taxpayer's trade or business shall not be considered a shareholder or other owner, and for such purposes an individual shall be treated as owning any interest owned by a member of his family (within the meaning of section 267(c)(4)). This paragraph shall not apply for purposes of subsection (a)(3).

(5) Employee, stockholder, etc., business meetings. Expenses incurred by a taxpayer which are directly related to business meetings of his employees, stockholders, agents, or directors.

(6) Meetings of business leagues, etc. Expenses directly related and necessary to attendance at a business meeting or convention of any organization described in section 501(c)(6) (relating to business leagues, chambers of commerce, real estate boards, and boards of trade) and exempt from taxation under section 501(a).

(7) Items available to public. Expenses for goods, services, and facilities made available by the taxpayer to the general public.

(8) Entertainment sold to customers. Expenses for goods or services (including the use of facilities) which are sold by the taxpayer in a bona fide transaction for an adequate and full consideration in money or money's worth.

(9) Expenses includible in income of persons who are not employees. Expenses paid or incurred by the taxpayer for goods, services, and facilities to the extent that the expenses are includible in the gross income of a recipient of the entertainment, amusement, or recreation who is not an employee of the taxpayer as compensation for services rendered or as a prize or award under section 74. The preceding sentence shall not apply to any amount paid or incurred by the taxpayer if such amount is required to be included (or would be so required except that the amount is less than \$ 600) in any information return filed by such taxpayer under part III of subchapter A of chapter 61 and is not so included.

For purposes of this subsection, any item referred to in subsection (a) shall be treated as an expense.

(f) Interest, taxes, casualty losses, etc. This section shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business (or with his income-producing activity). In the case of a taxpayer which is not an individual, the preceding sentence shall be applied as if it were an individual.

(g) Treatment of entertainment, etc., type facility. For purposes of this chapter, if deductions are disallowed under subsection (a) with respect to any portion of a facility, such portion shall be treated as an asset which is used for personal, living, and family purposes (and not as an asset used in the trade or business).

(h) Attendance at conventions, etc.

(1) In general. In the case of any individual who attends a convention, seminar, or similar meeting which is held outside the North American area, no deduction shall be allowed under section 162 for expenses allocable to such meeting unless the taxpayer establishes that the meeting is *directly related to the active conduct of his trade or business* and that, after taking into account in the manner provided by regulations prescribed by the Secretary--

(A) the purpose of such meeting and the activities taking place at such meeting,

(B) the purposes and activities of the sponsoring organizations or groups,

(C) the residences of the active members of the sponsoring organization and the places at which other meetings of the sponsoring organization or groups have been held or will be held, and

(D) such other relevant factors as the taxpayer may present,

it is as reasonable for the meeting to be held outside the North American area as within the North American area.

(2) Conventions on cruise ships. In the case of any individual who attends a convention, seminar, or other meeting which is held on any cruise ship, no deduction shall be allowed under section 162 for expenses allocable to such meeting, unless the taxpayer meets the requirements of paragraph (5) and establishes that the meeting is directly related to the active conduct of his trade or business and that--

(A) the cruise ship is a vessel registered in the United States; and

(B) all ports of call of such cruise ship are located in the United States or in possessions of the United States.

With respect to cruises beginning in any calendar year, not more than \$ 2,000 of the expenses attributable to an individual attending one or more meetings may be taken into account under section 162 by reason of the preceding sentence.

§ 451. General rule for taxable year of inclusion

(a) General rule.--The amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

§ 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.

§ 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*. 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. In the case of interest, dividends, or other earnings (whether or not credited) payable in respect of any deposit or account in a bank, building and loan association, savings and loan association, or similar institution, the following are not substantial limitations or restrictions on the taxpayer's control over the receipt of such earnings: (1) A requirement that the deposit or account, and the earnings thereon, must be withdrawn in multiples of even amounts; (2) The fact that the taxpayer would, by withdrawing the earnings during the taxable year, receive earnings that are not substantially less in comparison with the earnings for the corresponding period to which the taxpayer would be entitled had he left the account on deposit until a later date (for example, if an amount equal to three months' interest must be forfeited upon withdrawal or redemption before maturity of a one year or less certificate of deposit, time deposit, bonus plan, or other deposit arrangement then the earnings payable on premature withdrawal or redemption would be substantially less when compared with the earnings available at maturity);

§ 461. General rule for taxable year of deduction

(a) General rule.--The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

* * *

(f) Contested liabilities.--If--- * * *

(g) Prepaid interest.--

(1) In general.--If the taxable income of the taxpayer is computed under the cash receipts and disbursements method of accounting, interest paid by the taxpayer which, under regulations prescribed by the Secretary, is properly allocable to any period--

(A) with respect to which the interest represents a charge for the use or forbearance of money, and

(B) which is after the close of the taxable year in which paid, shall be charged to capital account and shall be treated as paid in the period to which so allocable.

(2) Exception.--This subsection shall not apply to *points* paid in respect of any indebtedness incurred in connection with the *purchase or improvement of, and secured by, the principal residence of the taxpayer* to the extent that, under regulations prescribed by the Secretary, such payment of points is an established business practice in the area in which such indebtedness is incurred, and the amount of such payment does not exceed the amount generally charged in such area.

(h) Certain liabilities not incurred before economic performance.--

(1) In general.--For purposes of this title, in determining whether an amount has been incurred with respect to any item during any taxable year, *the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.*

(2) Time when economic performance occurs.--Except as provided in regulations prescribed by the Secretary, the time when economic performance occurs shall be determined under the following principles:

(A) Services and property provided to the taxpayer.--If the liability of the taxpayer arises out of--

(i) the providing of services to the taxpayer by another person, economic performance occurs as such person provides such services,

(ii) the providing of property to the taxpayer by another person, economic performance occurs as the person provides such property, or

(iii) the use of property by the taxpayer, economic performance occurs as the taxpayer uses such property.

(B) Services and property provided by the taxpayer.--If the liability of the taxpayer requires the taxpayer to provide property or services, economic performance occurs as the taxpayer provides such property or services.

(C) Workers compensation and tort liabilities of the taxpayer.--If the liability of the taxpayer requires a payment to another person and--

- (i) arises under any workers compensation act, or
- (ii) *arises out of any tort,*

economic performance occurs as the payments to such person are made. Subparagraphs (A) and (B) shall not apply to any liability described in the preceding sentence.

(3) Exception for certain recurring items.--

(A) In general.--Notwithstanding paragraph (1) an item shall be treated

* * *

(4) All events test.--For purposes of this subsection, the all events test is met with respect to any item if all events have occurred which determine the fact of liability and the amount of such liability can be determined with reasonable accuracy.

Sec. 469. Passive activity losses and credits limited

(a) Disallowance.

(1) In general. If for any taxable year the taxpayer is described in paragraph (2), neither--

- (A) the passive activity loss, nor
 - (B) the passive activity credit,
- for the taxable year shall be allowed.

(2) Persons described. The following are described in this paragraph:

- (A) any individual, estate, or trust,
- (B) any closely held C corporation, and
- (C) any personal service corporation.

(b) Disallowed loss or credit carried to next year. Except as otherwise provided in this section, any loss or credit from an activity which is disallowed under subsection (a) shall be treated as a deduction or credit allocable to such activity in the next taxable year.

(c) Passive activity defined. For purposes of this section--

(1) In general. The term 'passive activity' means any activity--

- (A) which involves the conduct of any trade or business, and*
- (B) in which the taxpayer does not materially participate.*

(2) Passive activity includes any rental activity. Except as provided in paragraph (7), the term "passive activity" includes any rental activity.

(3) Working interests in *oil and gas property*.

(A) In general. The term 'passive activity' shall not include any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer with respect to such interest.

(B) Income in subsequent years. If any taxpayer has any loss for any taxable year from a working interest in any oil or gas property which is treated as a loss which is not from a passive activity, then any net income from such property (or any property the basis of which is determined in whole or in part by reference to the basis of such property) for any succeeding taxable year shall be treated as income of the taxpayer which is not from a passive activity. If the preceding sentence applies to the net income from any property for any taxable year, any credits allowable under subpart B (other than section 27(a)) or D of part IV of subchapter A for such taxable year which are attributable to such property shall be treated as credits not from a passive activity to the extent the amount of such credits does not exceed the regular tax liability of the taxpayer for the taxable year which is allocable to such net income.

(4) Material participation not required for paragraphs (2) and (3). Paragraphs (2) and (3) shall be applied without regard to whether or not the taxpayer materially participates in the activity.

(5) Trade or business includes research and experimentation activity. For purposes of paragraph (1)(A), the term 'trade or business' includes any activity involving research or experimentation (within the meaning of section 174).

(6) Activity in connection with trade or business or production of income. To the extent provided in regulations, for purposes of paragraph (1)(A), the term 'trade or business' includes--

(A) any activity in connection with a trade or business, or

(B) any activity with respect to which expenses are allowable as a deduction under section 212.

(7) Special rules for taxpayers in real property business.

(A) In general. If this paragraph applies to any taxpayer for a taxable year--

(i) paragraph (2) shall not apply to any rental real estate activity of such taxpayer for such taxable year, and

(ii) this section shall be applied as if each interest of the taxpayer in rental real estate were a separate activity.

Notwithstanding clause (ii), a taxpayer may elect to treat all interests in rental real estate as one activity. Nothing in the preceding provisions of this subparagraph shall be construed as affecting the determination of whether the taxpayer materially participates with respect to any interest in a limited partnership as a limited partner.

(B) Taxpayers to whom paragraph applies. This paragraph shall apply to a taxpayer for a taxable year if--

(i) more than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and

(ii) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates.

In the case of a joint return, the requirements of the preceding sentence are satisfied if and only if either spouse separately satisfies such requirements. For purposes of the preceding sentence, activities in which a spouse materially participates shall be determined under subsection (h).

(C) Real property trade or business. For purposes of this paragraph, the term "real property trade

or business" means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

(D) Special rules for subparagraph (b).

(i) Closely held C corporations. In the case of a closely held C corporation, the requirements of subparagraph (B) shall be treated as met for any taxable year if more than 50 percent of the gross receipts of such corporation for such taxable year are derived from real property trades or businesses in which the corporation materially participates.

(ii) Personal services as an employee. For purposes of subparagraph (B), personal services performed as an employee shall not be treated as performed in real property trades or businesses. The preceding sentence shall not apply if such employee is a 5-percent owner (as defined in section 416(i)(1)(B)) in the employer.

(d) Passive activity loss and credit defined. For purposes of this section--

(1) Passive activity loss. The term 'passive activity loss' means the amount (if any) by which--

(A) the aggregate losses from all passive activities for the taxable year, exceed

(B) the aggregate income from all passive activities for such year.

(2) Passive activity credit. The term 'passive activity credit' means the amount (if any) by which--

-

(A) the sum of the credits from all passive activities allowable for the taxable year under--(i) subpart D of part IV of subchapter A, or

(ii) subpart B (other than section 27(a)) of such part IV, exceeds

(B) the regular tax liability of the taxpayer for the taxable year allocable to all passive activities.

(h) Material participation defined. For purposes of this section--

(1) In general. A taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is--

(A) regular,

(B) continuous, and

(C) substantial.

(2) Interests in limited partnerships. Except as provided in regulations, no interest in a limited partnership as a limited partner shall be treated as an interest with respect to which a taxpayer materially participates.

§ 1041. Transfers of property between spouses or incident to divorce.

(a) General rule. No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of)--

(1) a spouse, or

(2) a former spouse, but only if the transfer is incident to the divorce.

(b) Transfer treated as gift; transferee has transferor's basis. In the case of any transfer of property described in subsection (a)--

(1) for purposes of this subtitle, the property shall be treated as acquired by the transferee by gift, and

(2) the basis of the transferee in the property shall be the adjusted basis of the transferor.

(c) Incident to divorce. For purposes of subsection (a)(2), a transfer of property is incident to the divorce if such transfer--

(1) occurs within 1 year after the date on which the marriage ceases, or

(2) is related to the cessation of the marriage.

(d) Special rule where spouse is nonresident alien. Subsection (a) shall not apply if the spouse (or former spouse) of the individual making the transfer is a nonresident alien.

(e) Transfers in trust where liability exceeds basis. * * *