


**2024
National Income Tax
Workbook**

Chapter 3: Related Party Issues
PP 79 - 105



1

Power point slides – 2 ways!





www.canr.msu.edu/taxschool/2024-two-day-tax-seminar-powerpoint-slides

OR

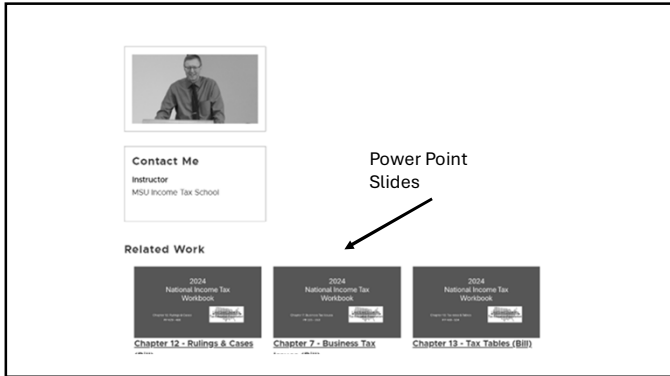


2

Find the 4 instructors under STAFF

 BILL VANEERDEN	 MARY JANE HOURANI
 PAM MOCK	 HEIDI BEUKEMA

3




This slide features a small portrait of a man in a suit at the top left. Below it is a 'Contact Me' box with the text 'Instructor MSU Income Tax School'. To the right, the text 'Power Point Slides' has an arrow pointing to three book covers under the heading 'Related Work'. The book covers are for '2024 National Income Tax Workbook' and are labeled 'Chapter 12 - Rulings & Cases', 'Chapter 7 - Business Tax', and 'Chapter 13 - Tax Tables (BIR)'.

4

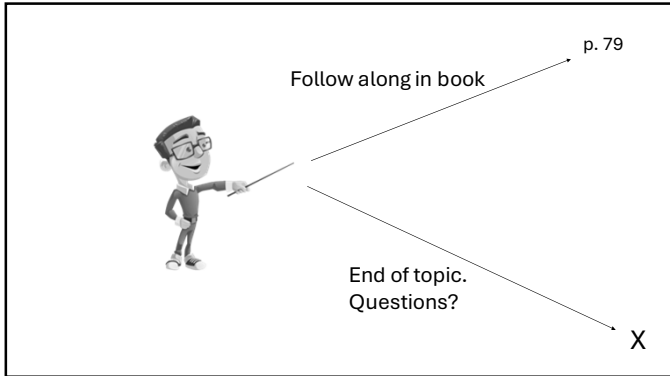
Tax Workbooks on-line:

In the next couple days, you will get an e-mail from Omnipress. It will provide you with a link to this year's tax book as well as prior years. Check your SPAM / JUNK



The logo consists of a black rectangle with the word 'omnipress' in white lowercase letters with a stylized 'i'. Below it, the text 'We help you deliver education' is written in white.

5



This slide shows a cartoon character of a man with glasses pointing to the right. Two arrows originate from his hand: one points to the text 'Follow along in book' which then has an arrow pointing to 'p. 79'; the other points to the text 'End of topic. Questions?' which then has an arrow pointing to an 'X'.

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Chapter Topics **79**

- **Issue 1: Limits on Losses and Deductions**
- **Issue 2: Transactions between Related Persons and Partnerships**
- **Issue 3: IRC 179 and Bonus Depreciation**
- **Issue 4: Gains from the Sale or Exchange of Depreciable Property**
- **Issue 5: Like -Kind Exchanges**
- **Issue 6: Installment Sales**

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Issue #1 – Limits on Losses and Deductions 81

IRC 267 RELATIONSHIPS - 13 Different types – page 81

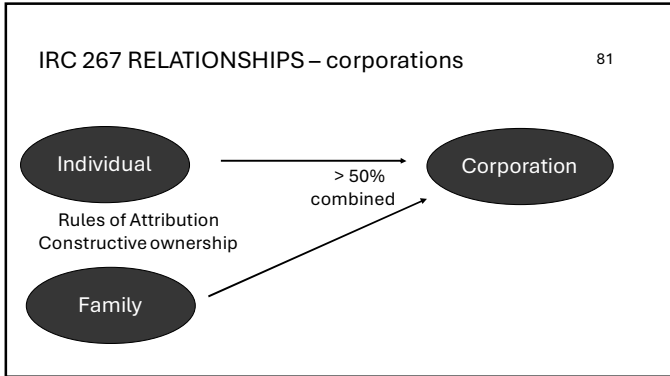
<ul style="list-style-type: none"> Family Individual Corporation Trusts Individual Corporation S Corporation Executor of Estate 	<ul style="list-style-type: none"> Family Corporation - more than 50% Corporation - more than 50% Beneficiary / grantor / fiduciary Controlled 501(c)(3) Partnership – if both owned over 50% C Corporation – if both owned over 50% Beneficiary of Estate
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8

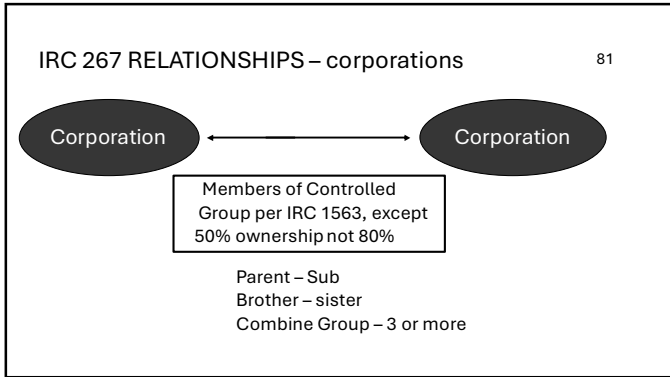
IRC 267 RELATIONSHIPS – family members 81

<p>Family member</p> <div style="border: 1px solid black; padding: 5px; margin: 5px 0;"> <p>YES</p> <ul style="list-style-type: none"> Brother Sister Half-brothers Half-sisters Ancestors Descendants </div>		<p>Family member</p> <div style="border: 1px solid black; padding: 5px; margin: 5px 0;"> <p>NO</p> <ul style="list-style-type: none"> Nieces Nephews Aunts Uncles Cousins In-laws Step-relatives </div>
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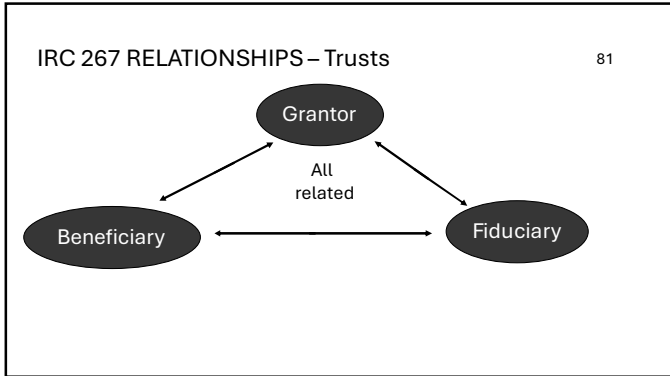
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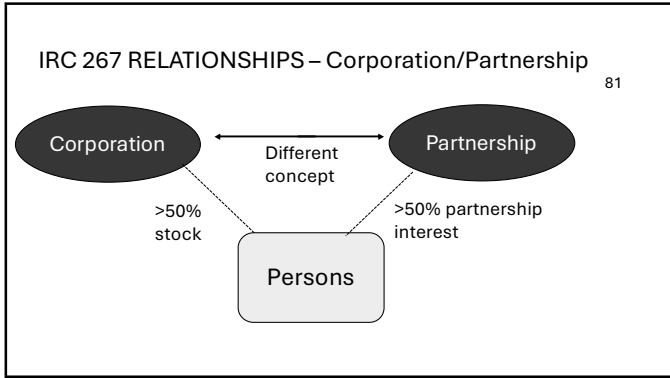
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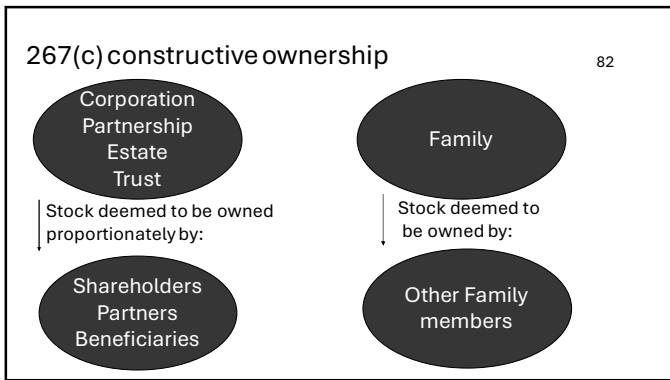
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12



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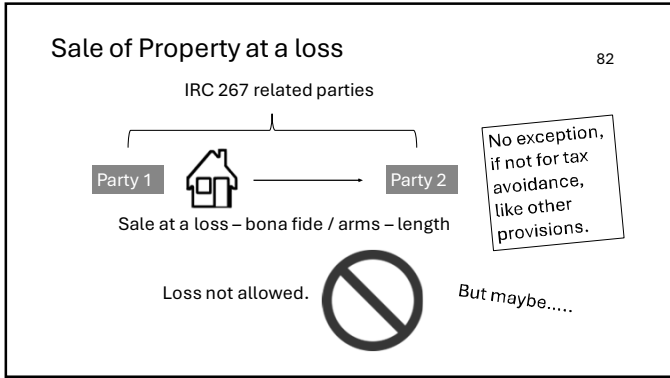
Related Parties 81

- Family
- Entities owned **over** 50% (including constructive ownership – page 82)
- Parties involved with Trusts

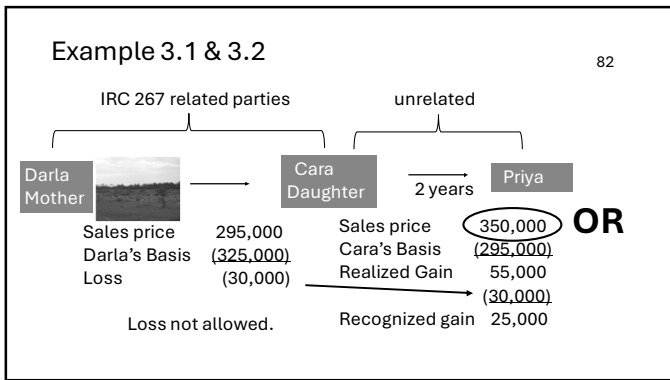
CONCEPT

Related Parties should not achieve a better tax result than unrelated parties.

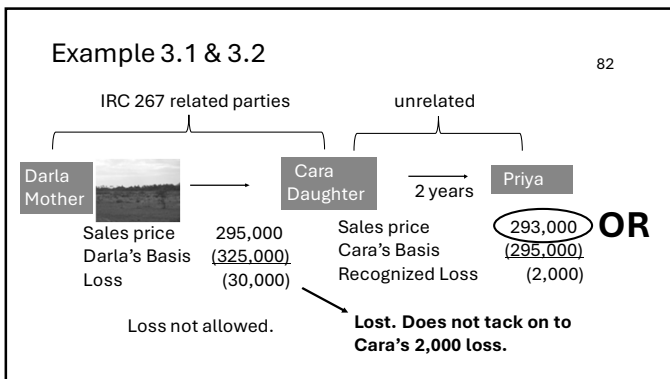
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Basis of Disallowed Loss property

83

IRC 267 related parties

Darla
Mother

Sales price 295,000
Darla's Basis (325,000)
Loss (30,000)

Loss not allowed.

Cara
Daughter

If Cara doesn't sell:

Cara's basis for depreciation is not affected by the potential allowance of the 30,000 disallowed loss. Also, potential recapture not affected.

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Example 3.3

83

Jacob
Father

Sales price 45,000
Jacob's Basis (50,000)
Loss (5,000)

Loss not allowed.

1/23 →

Caleb
Son

4/24 →

Unrelated party

Caleb's basis 45,000	No 179/bonus
Depr claimed (11,941)	
Basis 33,059	
Sold 46,000	
Realized Gain 12,941	
disallowed loss (1,000)	
recognized gain 11,941	

4,000 of disallowed loss lost

? recapture

X

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Matching Income & Expense Deductions

83

Payer

Related Party 1

Accrual

Deduction limited to amount reported in income

Rest deferred until income reported


Payee

Related Party 2

Cash

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Example 3.4 84

<p>Payer Baseline Corp</p> <p>Accrual 2024 Accrued 8,300 interest. None paid</p>		<p>Payee Xavier</p> <p>Owns 100% of stock</p> <p>Cash 2024 Since cash basis, no interest income reported</p>
---	---	---

No deduction until paid

22

Practitioner Note - Relationship Ceases? 84

<p>Payer Related Party 1</p> <p>Accrual</p>		<p>Payee Related Party 2</p> <p>Cash</p>
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Deduction limited to amount reported in income

Rest deferred until income reported

What if the relationship ceases before the income reported? Still deferred until income reported!!


X

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Issue #2 Transactions between related persons and partnerships 85



Partner

> 50%



Partner

Owns > 50% of both

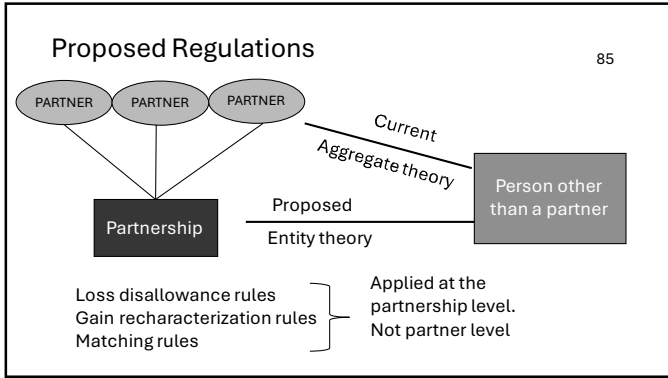



Sale or exchange of property

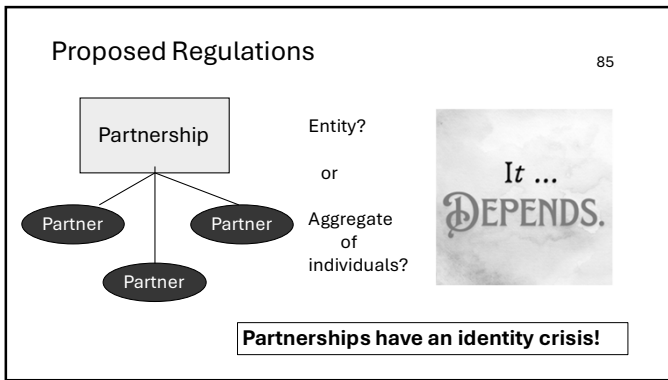
- 707(b)(1) limits loss deductions
- 707(b)(2) treats certain gains as ordinary income

Not 267!
Not 1239!

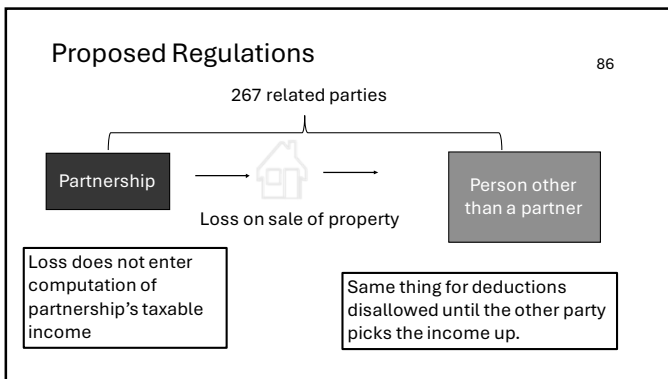
24



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Partnership Interest buy out 86 + 87

Buy sell agreement requires partnership to distribute a 1/3 interest in all partnership assets and then requires Steven to sell assets back.

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Partnership Interest buy out 86 + 87

Step #1 – partnership distributes 1/3 interest in assets to Steven

1. No gain or loss to partnership on distribution
2. If proportionate distribution of property – no gain or loss to Steven

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Partnership Interest buy out 86 + 87

- Steven is deemed to own Frank's 50% interest.
- BUT because the constructive ownership is not MORE than 50%, Steven and the partnership are not related parties.

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Partnership Interest buy out 86+87

Step #2 - Steven sells the 1/3 interest back to the partnership

- Since Steven and the Partnership are not related parties, Steven is not prohibited from claiming a loss. Not required to report certain gain as ordinary
- The partnership is not prohibited from claiming 179

X

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Issue #3 - IRC 179 and Bonus Depreciation 88

A taxpayer cannot claim 179 for property acquired from a related party. Related party defined a little differently:

<p>Normal related party rules</p> <p>Attribution rules and constructive stock ownership rules include brothers and sisters</p>	<p>179 related party rules</p> <p>Attribution rules and constructive stock ownership rules do not include brothers and sisters</p>
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Example 3.5 179 election – related parties 88

Rules of Attribution – Zayden owns 100%

33

Example 3.5 179 election – related parties 88

A to Z Corporation

50% Amir brother

50% Zayden brother

Sold equipment for 50,000

Does qualify for 179

Rules of Attribution don't apply

34

Bonus Depreciation (60% in 2024) 88 - 89

5 requirements to claim bonus depreciation on *used* equipment :

#2 Property was not acquired from a related party

IRC 179(d)(2)(A) Definition of related party → ← IRC 168(k): related party for Bonus Depreciation

X

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Issue #4 – gain from sale of property 90

Background:

IRC 1231 – Sale of property used in a trade or business.

- > Gain is Capital (except recapture)
- > Losses are ordinary

IRC 1239 – Gains from sales of depreciable property between related parties is ordinary.

FORM 4797

Remember last year?

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Issue #4 – gain from sale of property 90

IRC 1239 – Generally: Gain on sales between related persons is ordinary.

- If property **is depreciable** in hands of transferee
- Related persons is defined differently than IRC 267
 - **Person and all entities controlled by that person (over 50%)**
 - **Controlled groups of corporations, partnerships and S Corps (common ownership)**
 - **Beneficiaries and Trusts**
 - **Executor and beneficiaries of Estates**

MISSING: Family members!!

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Example 3.6 90

SG Realty Inc - S Corp

Sam father (50%) George son (50%)

Under rules of attribution, George is deemed to own Sam's 50%, so 100%

Sales price 4,500,000
Basis (1,500,000)
Gain 3,000,000

1250 property, would be Capital Gains

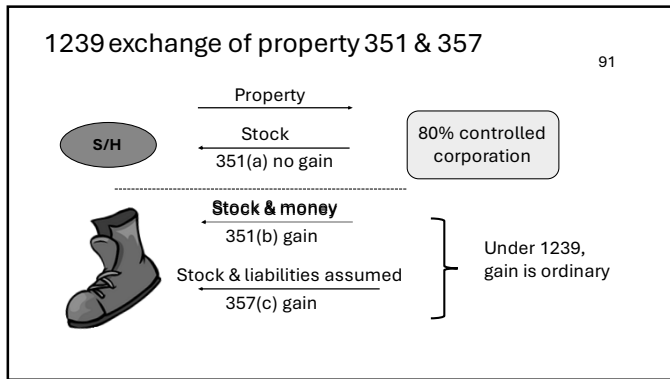
ORDINARY!

38

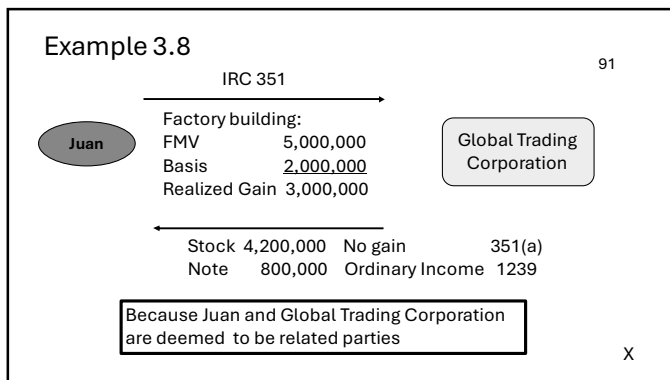
Example 3.7 91

	2/23	depr 66,338	4/24		
Anastasia purchased for 250,000 	Sold Basis Gain Depr rec 1239	255,000 (183,662) 71,338 (66,338) 5,000	ordinary ordinary	→ Corporation	<p>mom dad</p> <p>Anastasia deemed to own stock</p>

39



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Issue #5 Like Kind Exchanges 92

Covered extensively last year! Chapter 10 in the 2023 Workbook

REMEMBER:

- Only Real Property Real = Broad definition
- Incidental personal property OK
- Use of qualified intermediary
- Timing requirements – 45 days, 180 days
- Qualified Use (can't give replacement property to kids)
- Calculation of gain and basis – boot
- Form 8824
- Combining 1031 and 121 exclusion
- Vacation Homes

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Related party exchanges 92

Like kind exchange between related parties

Both parties file an 8824 for the year of sale and the following 2 years

2 years

Either party sells one of the properties, both parties must recognize the deferred gain!

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Example 3.9 93

Ella - mother

FMV	100,000
Basis	60,000
Deferred	40,000

← Like kind exchange →

July 2023

Gretta - Daughter

FMV	100,000
Basis	80,000
Deferred	20,000

2024
Gain recognized 40,000!
Basis now 100,000

Surprise!

April 2024 Sale
Sale 102,000
Gain 22,000

44

Related Party gain recognition exceptions 93

- ☼ Death
- ☼ Involuntary
- ☼ Not done to avoid Federal Income Tax
IE: Derive no tax advantage

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Example 3.9 93

Ella - mother Gretta

Like kind exchange Gretta Dies Gretta's spouse

July 2023 Sells property 7/1/2024

FMV 100,000 Basis 60,000 Deferred 40,000	FMV 100,000 Basis 80,000 Deferred 20,000
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2024
 No Gain

X

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Issue 6 – Installment Sales 94

YES	NO
<ul style="list-style-type: none"> ➤ Gains ➤ Seller receives at least one payment after the close of the tax year ➤ Mandatory 	<ul style="list-style-type: none"> ➤ Losses ➤ Recapture gain ➤ Dealer dispositions ➤ Personal property that is inventory ➤ Stock or securities
<ul style="list-style-type: none"> ➤ Sales of non-depreciable property to related persons 	<ul style="list-style-type: none"> ➤ Sales of depreciable property to related persons (unless tax avoidance is not a principal purpose)


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Installment Sales 94

Non-depreciable property	Depreciable property
<u>Original sale</u> Can sell to related parties without establishing that tax avoidance not a principal purpose	<u>Original sale</u> Cannot sell to related parties without establishing that tax avoidance not a principal purpose. But, related party does not include family member
<u>Second disposition</u> Does not accelerate gain recognition if not done for tax avoidance	<u>Second disposition</u> Does not accelerate gain recognition if not done for tax avoidance

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Not for the primary purpose of tax avoidance 94

Unless **Not for:** 

Second sale:
forced sale, second sale also an installment sale, involuntary conversion, death

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Related Party Installment Sales 94-95

Original Sale All payments 2 years

Earlier of
Related party sells property

Unless

Original seller is treated as receiving the amount realized on the 2nd disposition, regardless of whether the related person makes a payment to the original seller.

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Example 3.11 95

Tasha Mother Jackie Daughter

2023	Sales price	240,000	} Gross profit % = 40%
	Basis	(144,000)	
	Gain	96,000	

Down payment 60,000 X 40% = 24,000 income for 2023
 Promissory note 180,000
 (60,000/ year for 3 years)

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Example 3.11 95 - 97

Tasha Mother		Jackie Daughter	2024	Unrelated party
Sold for 250,000 (not paid to mother)				
Instalment sale income 2024				
24,000	X 40% GPP	60,000 in payments	Form 6252 Part II	
48,000	X 40% GPP	120,000 payments <u>deemed received</u>	Form 6252 Part III	
72,000				
24,000 reported in 2023				
96,000 total gain				

Page 97

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Example 3.12 98

Tasha Mother		Jackie Daughter	2024	Unrelated party
Sold for <u>210,000</u>				
Instalment sale income 2024				
24,000	X 40% GPP	60,000 in payments	Lesser of amount realized on 2 nd sale or first disposition contract price 210,000 (60,000) 2023 (60,000) 2024 90,000	
<u>36,000</u>	X 40% GPP	<u>90,000 payments</u> deemed received ?		
60,000				

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Example 3.12 continued 98

What about future years?

2025
Remember, 3 annual installments of 60,000
No gain to report because she already reported more gain than originally scheduled to be reported.

Originally scheduled		Actually reported	
2024 60,000 x .40 = 24,000	} 48,000	150,000 x .40 = 60,000	
2025 60,000 x .40 = 24,000			
2026 60,000 x .40 = 24,000			

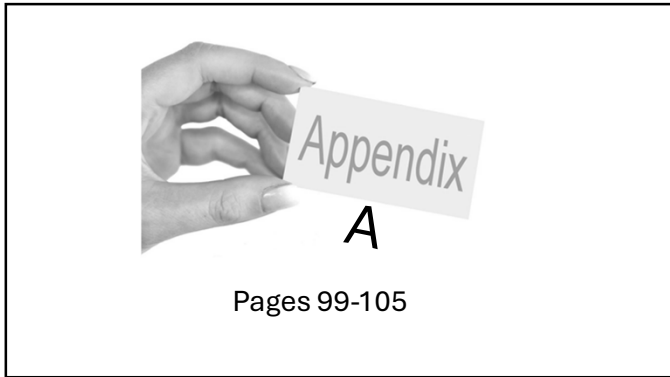
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Example 3.12 continued 98

		<u>GPP</u>	<u>Gain</u>
Original disposition contract price	240,000	x 40% =	96,000
<hr/>			
Payments received in 2023	(60,000)	x 40% =	24,000
Payments received in 2024	(60,000)	x 40% =	24,000
Payments deemed received in 2024	(90,000)	x 40% =	36,000
Payments in 2025 (because picked up in 2024)			-0-
Balance - 2026	(30,000)	x 40% =	<u>12,000</u>
	240,000		96,000

X

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