DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9509]

RIN 1545–BE23

Farmer and Fisherman Income Averaging

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the averaging of farm and fishing income in computing income tax liability. The regulations reflect changes made by the American Jobs Creation Act of 2004 and the Tax Extenders and Alternative Minimum Tax Relief Act of 2008. The regulations provide guidance to individuals engaged in a farming or fishing business who elect to reduce their tax liability by treating all or a portion of the current taxable year's farm or fishing income as if one-third of it had been earned in each of the prior three taxable years.

DATES: *Effective Date:* These regulations are effective on December 15, 2010.

Applicability Date: For date of applicability, see § 1.1301–1(g).

FOR FURTHER INFORMATION CONTACT: Erika Reigle, (202) 622–4950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains amendments to 26 CFR part 1. On July 22, 2008, temporary regulations (TD 9417) were published in the **Federal Register** (73 FR 42522) relating to the averaging of farm and fishing income in computing tax liability. A notice of proposed rulemaking (REG–161695–04) cross-referencing the temporary regulations also was published in the **Federal Register** (73 FR 42538) on July 22, 2008. No comments in response to the notice of proposed rulemaking or requests to hold a public hearing were received, and no hearing was held. This Treasury decision adopts the proposed regulations with minor changes and removes the temporary regulations.

Section 504 of the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, Div. C of Public Law 110–343 (122 Stat. 3765), enacted on October 3, 2008, provides that a taxpayer may treat qualified settlement income received in connection with the civil action *In re Exxon Valdez,* No. 8–095–CV (HRH) (Consolidated) (D. Alaska), as income from a fishing business eligible for income averaging. Therefore, these final regulations include this qualified settlement income in the definition of income from a fishing business. Qualified settlement income is limited to interest and punitive damages. The extent to which compensatory damages are treated as income from a fishing business is determined under the generally applicable rules of section 1301.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Erika Reigle of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.1301–1 is amended by revising the section heading and paragraphs (a), (b)(1), (b)(3), (c)(1), (d)(3)(ii), (d)(4), (e), (f)(2), (f)(4), and (g) to read as follows:

§ 1.1301–1 Averaging of farm and fishing income.

(a) *Overview.* An individual engaged in a farming or fishing business may make a farm income averaging election to compute current year (election year) income tax liability under section 1 by averaging, over the prior three-year period (base years), all or a portion of the individual's current year electible farm income as defined in paragraph (e) of this section. Electible farm income includes income from both farming and fishing businesses. An individual who makes a farm income averaging election—

(1) Designates all or a portion of the individual's electible farm income for the election year as elected farm income; and

(2) Determines the election year section 1 tax by calculating the sum of—

(i) The section 1 tax that would be imposed for the election year if taxable income for the year were reduced by elected farm income; plus

(ii) The amount by which the section 1 tax would be increased if taxable income for each base year were increased by one-third of elected farm income.

(b) *Individual engaged in a farming or fishing business*—(1) *In general*—(i) *Farming or fishing business.* "Farming business" has the same meaning as provided in section 263A(e)(4) and the regulations under that section. *Fishing business* means the conduct of commercial fishing as defined in section 3 of the Magnuson-Stevens Fishery Conservation and Management Act (16 U.S.C. 1802(4)). Accordingly, a fishing business is fishing in which the fish harvested are intended to or do enter commerce through sale, barter, or trade. *Fishing* means the catching, taking, or harvesting of fish; the attempted catching, taking, or harvesting of fish; any activities that reasonably can be expected to result in the catching, taking, or harvesting of fish; or any operations at sea in support of or in preparation for the catching, taking, or harvesting of fish. Fishing does not include any scientific research activity conducted by a scientific research vessel. *Fish* means finfish, mollusks, crustaceans, and all other forms of marine animal and plant life, other than marine mammals and birds. *Catching, taking, or harvesting* includes activities that result in the killing of fish or the bringing of live fish on board a vessel.

(ii) *Exxon Valdez settlement payments.* For purposes of this section, a qualified taxpayer who receives qualified settlement income in any taxable year is treated as engaged in a fishing business, and the income is treated as income attributable to a fishing business, for that taxable year. A *qualified taxpayer* is an individual plaintiff in the civil action *In re Exxon*

Valdez, No. 89–095–CV (HRH) (Consolidated) (D. Alaska). *Qualified taxpayer* also means any individual who is a beneficiary of the estate of such a plaintiff, was the spouse or immediate relative of that plaintiff, and acquired the right to receive the settlement income from that plaintiff. *Qualified settlement income* means any interest and punitive damage awards that are received in connection with the civil action *In re Exxon Valdez* (whether as lump-sum or periodic payments, whether pre- or post-judgment, and whether related to a settlement or to a judgment) and that are otherwise includible in income.

(iii) *Form of business.* An individual engaged in a farming or fishing business includes a sole proprietor of a farming or fishing business, a partner in a partnership engaged in a farming or fishing business, and a shareholder of an S corporation engaged in a farming or fishing business. Except as provided in paragraph (e)(1)(i) of this section, services performed as an employee are disregarded in determining whether an individual is engaged in a farming or fishing business for purposes of section 1301 of the Internal Revenue Code.

(iv) *Base years.* An individual is not required to have been engaged in a farming or fishing business in any of the base years in order to make a farm income averaging election.

* * * * *

(3) *Lessors of vessels used in fishing.* A lessor of a vessel is engaged in a fishing business for purposes of section 1301 with respect to payments that are received under the lease and are based on a share of the catch from the lessee's use of the vessel in a fishing business (or a share of the proceeds from the sale of the catch) if this manner of payment is determined under a written lease agreement entered into before the lessee begins any significant fishing activities resulting in the catch. A lessor of a vessel is not engaged in a fishing business for purposes of section 1301 with respect to fixed lease payments or with respect to lease payments based on a share of the lessee's catch (or a share of the proceeds from the sale of the catch) if the share is determined under either an unwritten agreement or a written agreement entered into after the lessee begins significant fishing activities resulting in the catch.

(c) *Making, changing, or revoking an election*—(1) *In general.* A farm income averaging election is made by filing Schedule J, "Income Averaging for Farmers and Fishermen," with an individual's Federal income tax return for the election year (including a late or amended return if the period of limitation on filing a claim for credit or refund has not expired).

* * * * *

(d) * * *

(3) * * *

(ii) *Example.* The rules of this paragraph (d)(3) are illustrated by the following example:

Example. (i) T is a fisherman who uses the calendar taxable year. In each of the years 2007, 2008, and 2009, T's taxable income is $20,000, none of which is electible farm income. In 2010, T has taxable income of $30,000 (prior to any farm income averaging election), $10,000 of which is electible farm income. T makes a farm income averaging election with respect to $9,000 of the electible farm income for 2010. Under paragraph (a)(2)(ii) of this section, $3,000 of elected farm income is allocated to each of the base years 2007, 2008, and 2009. Under paragraph (a)(2) of this section, T's 2010 tax liability is the sum of the following amounts:

(A) The section 1 tax on $21,000, which is T's taxable income of $30,000, minus elected farm income of $9,000.

(B) For each of the base years 2007, 2008, and 2009, the amount by which the section 1 tax would be increased if one-third of elected farm income were allocated to each year. The amount for each year is the section 1 tax on $23,000 (T's taxable income of $20,000, plus $3,000, which is one-third of elected farm income for the 2010 election year), minus the section 1 tax on $20,000.

(ii) In 2011, T has taxable income of $50,000, $12,000 of which is electible farm income. T makes a farm income averaging election with respect to all $12,000 of the electible farm income for 2011. Under paragraph (a)(2)(ii) of this section, $4,000 of elected farm income is allocated to each of the base years 2008, 2009, and 2010. Under paragraph (a)(2) of this section, T's 2011 tax liability is the sum of the following amounts:

(A) The section 1 tax on $38,000, which is T's taxable income of $50,000, minus elected farm income of $12,000.

(B) For each of the base years 2008 and 2009, the amount by which section 1 tax would be increased if, after adjustments for previous farm income averaging elections pursuant to paragraph (d)(3)(i) of this section, one-third of 2011 elected farm income were allocated to each year. The amount for each year is the section 1 tax on $27,000 (T's taxable income of $20,000 increased by $3,000 for T's 2010 farm income averaging election and further increased by $4,000, which is one-third of elected farm income for the 2011 election year), minus the section 1 tax on $23,000 (T's taxable income of $20,000 increased by $3,000 for T's 2010 farm income averaging election).

(C) For base year 2010, the amount by which section 1 tax would be increased if, after adjustments for previous farm income averaging elections pursuant to paragraph (d)(3)(i) of this section, one-third of elected farm income were allocated to that year. This amount is the section 1 tax on $25,000 (T's 2010 taxable income of $30,000 reduced by $9,000 for T's 2010 farm income averaging election and increased by $4,000, which is one-third of elected farm income for the 2011 election year), minus the section 1 tax on $21,000 (T's taxable income of $30,000 reduced by $9,000 for T's 2010 farm income averaging election).

(4) *Deposits into Merchant Marine Capital Construction Fund*—(i) *Reductions to taxable income and electible farm income.* Under section 7518(c)(1)(A), certain deposits to a Merchant Marine Capital Construction Fund (CCF) reduce taxable income for purposes of the Internal Revenue Code (the CCF reduction). The amount of the CCF reduction is limited under section 7518(a)(1)(A) to the taxpayer's taxable income (determined without regard to the reduction) attributable to specified maritime operations including operations in fisheries of the United States. The CCF reduction is taken into account in determining the taxable income used in computations under this section. In addition, except to the extent the amount described in section 7518(a)(1)(A) is not attributable to the individual's fishing business, the CCF reduction is treated in computing electible farm income as an item of deduction attributable to the individual's fishing business.

(ii) *Example.* The rules of this paragraph (d)(4) are illustrated by the following example:

Example. (i) T is a fisherman who uses the calendar taxable year. In each of the years 2007, 2008, and 2009, T's taxable income (before taking any CCF reduction into account) is $20,000. For taxable year 2008, all of T's income is described in section 7518(a)(1)(A) and is attributable to T's fishing business. T makes a $5,000 deposit into a CCF for taxable year 2008. In 2010, T has total taxable income of $30,000 (before taking any CCF reduction into account). T's electible farm income for 2010 (before taking the CCF reduction into account) is $10,000, all of which is described in section 7518(a)(1)(A) and is attributable to T's fishing business. For taxable year 2010, T makes a $4,000 deposit into a CCF.

(ii) The amount of the 2010 CCF deposit reduces taxable income. Accordingly, T's taxable income for 2010 is $26,000 ($30,000–$4,000). In addition, the entire amount of the CCF reduction is treated as an item of deduction attributable to T's fishing business. Accordingly, T's electible farm income for 2010 is $6,000 ($10,000–$4,000). Similarly, the amount of the 2008 CCF deposit reduces T's taxable income for 2008. Accordingly, T's taxable income for 2008 is $15,000 ($20,000–$5,000).

(iii) T makes an income averaging election with respect to all $6,000 of the electible farm income for 2010. Under paragraph (a)(2)(ii) of this section, $2,000 of elected farm income is allocated to each of the base years 2007, 2008, and 2009. Under paragraph (a)(2) of this section, T's 2010 tax liability is the sum of the following amounts:

(A) The section 1 tax on $20,000, which is T's taxable income of $26,000 ($30,000 reduced by the $4,000 CCF deposit), minus elected farm income of $6,000.

(B) For each of the base years 2007, 2008, and 2009, the amount by which section 1 tax would be increased if one-third of elected farm income were allocated to each year. The amount for base years 2007 and 2009 is the section 1 tax on $22,000, (T's taxable income of $20,000, plus $2,000, which is one-third of elected farm income for the election year), minus the section 1 tax on $20,000. The amount for base year 2008 is the section 1 tax on $17,000, which is T's taxable income of $15,000 ($20,000 reduced by the $5,000 CCF deposit), plus $2,000 (one-third of elected farm income for the election year), minus the section 1 tax on $15,000.

(e) *Electible farm income*—(1) *Identification of items attributable to a farming or fishing business*—(i) *In general.* Farm and fishing income includes items of income, deduction, gain, and loss attributable to an individual's farming or fishing business. Farm and fishing losses include, to the extent attributable to a farming or fishing business, any net operating loss carryover or carryback or net capital loss carryover to an election year. Income, gain, or loss from the sale of development rights, grazing rights, and other similar rights is not treated as attributable to a farming business. In general, farm and fishing income does not include compensation received as an employee. However, a shareholder of an S corporation engaged in a farming or fishing business may treat compensation received from the corporation as farm or fishing income if the compensation is paid by the corporation in the conduct of the farming or fishing business. If a crewmember on a vessel engaged in commercial fishing (within the meaning of section 3 of the Magnuson-Stevens Fishery Conservation and Management Act, 16 U.S.C. 1802(4)) is compensated by a share of the boat's catch of fish or a share of the proceeds from the sale of the catch, the crewmember is treated for purposes of section 1301 as engaged in a fishing business and the compensation is treated for such purposes as income from a fishing business.

(ii) *Gain or loss on sale or other disposition of property*—(A) *In general.* Gain or loss from the sale or other disposition of property that was regularly used in the individual's farming or fishing business for a substantial period of time is treated as attributable to a farming or fishing business. For this purpose, the term *property* does not include land, but does include structures affixed to land. Property that has always been used solely in the farming or fishing business by the individual is deemed to meet both the regularly used and substantial period tests. Whether property not used solely in the farming or fishing business was regularly used in the farming or fishing business for a substantial period of time depends on all of the facts and circumstances.

(B) *Cessation of a farming or fishing business.* If gain or loss described in paragraph (e)(1)(ii)(A) of this section is realized after cessation of a farming or fishing business, the gain or loss is treated as attributable to a farming or fishing business only if the property is sold within a reasonable time after cessation of the farming or fishing business. A sale or other disposition within one year of cessation of the farming or fishing business is presumed to be within a reasonable time. Whether a sale or other disposition that occurs more than one year after cessation of the farming or fishing business is within a reasonable time depends on all of the facts and circumstances.

(2) *Determination of amount that may be elected farm income*—(i) *Electible farm income.* (A) The maximum amount of income that an individual may elect to average (electible farm income) is the sum of any farm and fishing income and gains, minus any farm and fishing deductions or losses (including loss carryovers and carrybacks) that are allowed as a deduction in computing the individual's taxable income.

(B) Individuals conducting both a farming business and a fishing business must calculate electible farm income by combining income, gains, deductions, and losses derived from the farming business and the fishing business.

(C) Except as otherwise provided in paragraph (d)(4) of this section, the amount of any CCF reduction is treated as a deduction from income attributable to a fishing business in calculating electible farm income.

(D) Electible farm income may not exceed taxable income, and electible farm income from net capital gain attributable to a farming or fishing business may not exceed total net capital gain. Subject to these limitations, an individual who has both ordinary income and net capital gain from a farming or fishing business may elect to average any combination of the ordinary income and net capital gain.

(ii) *Examples.* The rules of this paragraph (e)(2) are illustrated by the following examples:

Example 1. A has ordinary income from a farming business of $200,000 and deductible expenses from a farming business of $50,000. A's taxable income is $150,000 ($200,000–$50,000). Under paragraph (e)(2)(i) of this section, A's electible farm income is $150,000, all of which is ordinary income.

Example 2. B has capital gain of $20,000 that is not from a farming or fishing business, capital loss from a farming business of $30,000, and ordinary income from a farming business of $100,000. Under section 1211(b), B's allowable capital loss is limited to $23,000. B's taxable income is $97,000 (($20,000–$23,000) + $100,000). B has a capital loss carryover from a farming business of $7,000 ($30,000 total loss − $23,000 allowable loss). Under paragraph (e)(2)(i) of this section, B's electible farm income is $77,000 ($100,000 ordinary income from a farming business, minus $23,000 capital loss from a farming business), all of which is ordinary income.

Example 3. C has ordinary income from a fishing business of $200,000 and ordinary loss from a farming business of $60,000. C's taxable income is $140,000 ($200,000 − $60,000). Under paragraph (e)(2)(i)(B) of this section, C must deduct the farm loss from the fishing income in determining C's electible farm income. Therefore, C's electible farm income is $140,000 ($200,000–$60,000), all of which is ordinary income.

Example 4. D has ordinary income from a farming business of $200,000 and ordinary loss of $50,000 that is not from a farming or fishing business. D's taxable income is $150,000 ($200,000 − $50,000). Under paragraph (e)(2)(i)(D) of this section, electible farm income may not exceed taxable income. Therefore, D's electible farm income is $150,000, all of which is ordinary income.

Example 5. E has capital gain from a farming business of $50,000, capital loss of $40,000 that is not from a farming or fishing business, and ordinary income from a farming business of $60,000. E's taxable income is $70,000 (($50,000 − $40,000) + $60,000). Under paragraph (e)(2)(i)(D) of this section, electible farm income may not exceed taxable income, and electible farm income from net capital gain attributable to a farming or fishing business may not exceed total net capital gain. Therefore, E's electible farm income is $70,000 of which $10,000 is capital gain and $60,000 is ordinary income.

(f) * * *

(2) *Changes in filing status.* An individual is not prohibited from making a farm income averaging election solely because the individual's filing status is not the same in an election year and the base years. For example, an individual who is married and files a joint return in the election year, who filed as single in one or more of the base years, may elect to average farm or fishing income, by using the single filing status to compute the increase in section 1 taxes for the base years in which the individual filed as single.

* * * * *

(4) *Alternative minimum tax.* A farm income averaging election is disregarded in computing the tentative minimum tax and the regular tax under section 55 for the election year or any base year. The election is taken into

account, however, in determining the regular tax liability under section 53(c) for the election year.

* * * * *

(g) *Effective/applicability date.* This section applies for taxable years beginning after December 15, 2010. See the provisions of §§ 1.1301–1 and 1.1301–1T as in effect on December 14, 2010 for rules that apply for taxable years beginning on or before December 15, 2010. In addition, a taxpayer may apply paragraph (b)(1)(ii) of this section in taxable years beginning after December 31, 2003.

§ 1.1301–1T [Removed]

■ **Par. 3.** Section 1.1301–1T is removed.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Approved: December 7, 2010.

Michael Mundaca,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2010–31497 Filed 12–14–10; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9510]

RIN 1545–BJ54

Requirement of a Statement Disclosing Uncertain Tax Positions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations allowing the IRS to require corporations to file a schedule disclosing uncertain tax positions related to the tax return as required by the IRS.

DATES: *Effective date:* This regulation is effective on December 15, 2010.

Applicability date: For dates of applicability, see § 1.6012–2(a)(5).

FOR FURTHER INFORMATION CONTACT: Kathryn Zuba at (202) 622–3400 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 6012 relating to the returns of income corporations are required to file. Section 6011 provides that persons liable for a tax imposed by Title 26 shall make a return when required by regulations prescribed by the Secretary of the Treasury according to the forms and regulations prescribed by the Secretary. Treasury Regulation § 1.6011–1 requires every person liable for income tax to make the returns required by regulation. Section 6012 requires corporations subject to an income tax to make a return with respect to that tax. Treasury Regulation § 1.6012–2 sets out the corporations that are required to file returns and the form those returns must take.

A proposed regulation under section 6012 (REG–119046–10) was published in the **Federal Register** on September 9, 2010. Requirement of a Statement Disclosing Uncertain Tax Positions, 75 FR 54802 (proposed Sept. 9, 2010). The IRS received one written comment concerning the proposed regulation, and a public hearing regarding the proposed regulation was held on October 19, 2010. Neither of the two speakers at the public hearing had comments relating to the proposed regulation, although both organizations the speakers represented had previously submitted written comments concerning the draft Schedule UTP and instructions. Announcement 2010–30, 2010–19 IRB 668. After considering the comments, the proposed regulation is adopted by this Treasury decision with one non-substantive change related to the effective date. While the proposed regulation applied to returns filed for tax years beginning after December 15, 2009 and ending after the date the regulations were published in the **Federal Register**, the final regulation applies to returns filed for tax years beginning on or after January 1, 2010.

Explanation and Summary of Comments

This rule will authorize the IRS to require certain corporations, as set out in forms, publications, instructions, or other guidance, to provide information concerning uncertain tax positions concurrent with the filing of a return. On September 24, 2010, the IRS released Schedule UTP with accompanying instructions that explain how the IRS plans to implement the authority provided by this regulation. One commentator asked that the proposed regulation not be adopted because Schedule UTP would require the disclosure of privileged information. If the regulation is adopted, the commentator recommended it should state that taxpayer may assert any applicable privileges to providing information sought by Schedule UTP and that any disclosure of information on that schedule will not constitute a waiver of any applicable privilege.

The final regulation does not adopt this recommendation. The regulation addresses the IRS's authority to require certain corporations to provide information concerning uncertain tax positions. The IRS has decided to require the filing of Schedule UTP based on its determination that the information about uncertain tax positions taken in a tax return required by the schedule is essential to achieving an effective and efficient self-assessment tax system. Provisions relating to the assertion of privilege are not included in this regulation, since it does not affect the existence of any applicable privileges taxpayers may have concerning information requested by a return or how they may assert those privileges.

Special Analyses

It has been determined that this final rule is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

This regulation will only affect taxpayers that prepare or are required to issue audited financial statements. Small entities rarely prepare or are required to issue audited financial statements due to the expense involved. It is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). Accordingly, a regulatory flexibility analysis is not required. Pursuant to 5 U.S.C. 553(d)(3), it has been determined that there is good cause for the effective date of this final rule, which is less than 30 days after the date of publication.

Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Kathryn Zuba of the Office of the Associate Chief Counsel (Procedure and Administration).

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows: