


**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

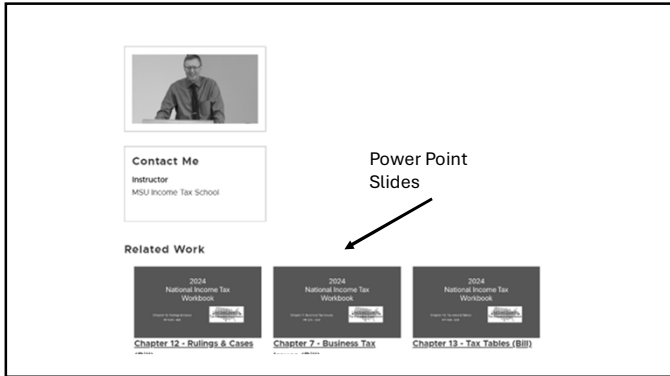


2

Find the 4 instructors under *STAFF*

<p>Team #1</p> <div style="display: flex; justify-content: space-around;"> <div style="text-align: center;">  <u>BILL VANEERDEN</u> </div> <div style="text-align: center;">  <u>MARY JANE HOURANI</u> </div> </div> <div style="display: flex; justify-content: space-around; margin-top: 20px;"> <div style="text-align: center;">  <u>HEIDI BEUKEMA</u> </div> <div style="text-align: center;">  <u>PAM MOCK</u> </div> </div>	
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3



Contact Me
Instructor
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Power Point Slides


Related Work

- 2024 National Income Tax Workbook
Chapter 12 - Rulings & Cases
- 2024 National Income Tax Workbook
Chapter 7 - Business Tax
- 2024 National Income Tax Workbook
Chapter 13 - Tax Tables (Bill)


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



5



Will be mailed to your address that MSU has on file.



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Follow slides

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

Follow along in book p. 79

Listen

Questions? 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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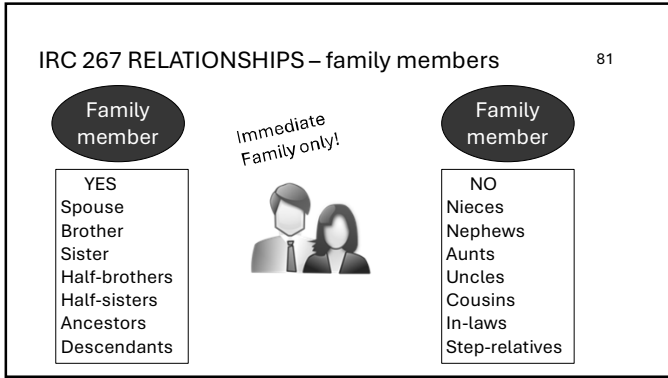
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Issue #1 – Limits on Losses and Deductions 81

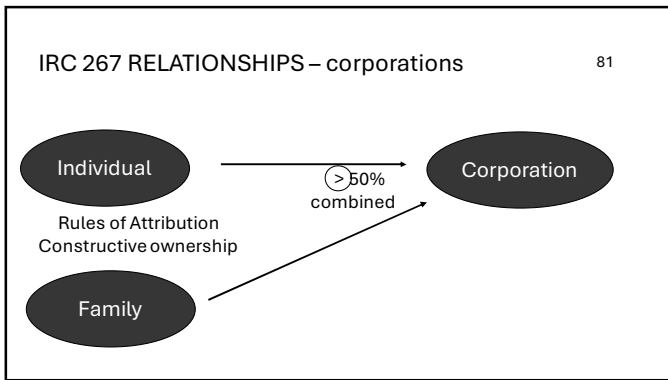
IRC 267 RELATIONSHIPS - 13 Different types – page 81

Family Individual Corporation Trusts Individual Corporation S Corporation Executor of Estate	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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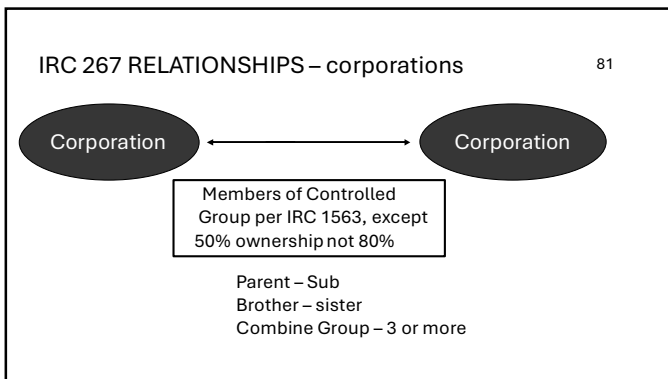
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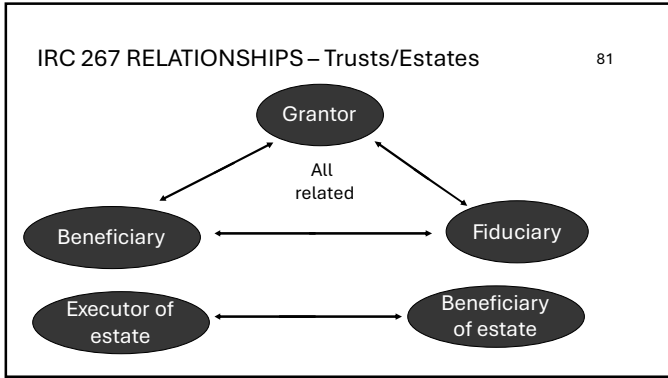
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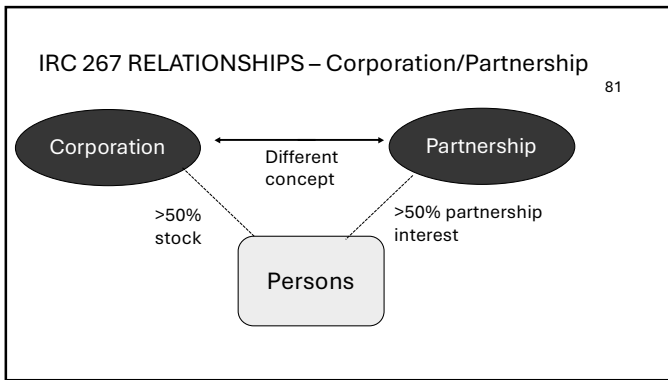
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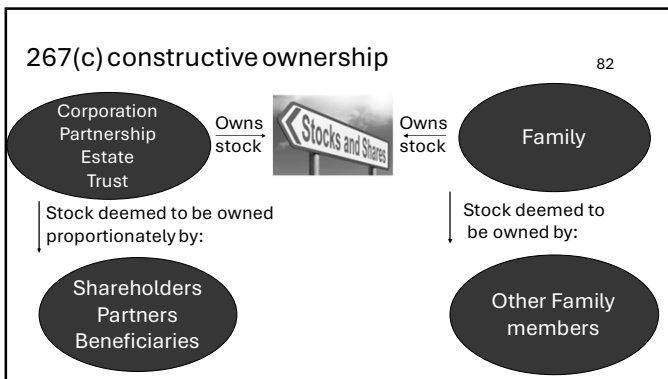
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Related Parties 81

common sense

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

CONCEPT

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

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Sale of Property at a loss 82

IRC 267 related parties

Party 1

Party 2

HUGE!!

No exception, if not for tax avoidance, like other provisions.

Sale at a loss – bona fide / arms – length

Loss not allowed.

But maybe.....
Party 2 can claim loss?

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Example 3.1 & 3.2 82

IRC 267 related parties

Darla Mother

unrelated

Cara Daughter

2 years

Priya

	Sales price	295,000		Sales price	350,000	OR
	Darla's Basis	(325,000)		Cara's Basis	(295,000)	
	Loss	(30,000)		Realized Gain	55,000	
					(30,000)	
	Loss not allowed.			Recognized gain	25,000	

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Example 3.1 & 3.2 82

IRC 267 related parties unrelated

Darla Mother → Cara Daughter → 2 years → Priya

Sales price	295,000	Sales price	293,000	OR
Darla's Basis	(325,000)	Cara's Basis	(295,000)	
Loss	(30,000)	Recognized Loss	(2,000)	

Loss not allowed. **Lost. Does not tack on to Cara's 2,000 loss.**

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Basis of Disallowed Loss property 83

IRC 267 related parties

Darla Mother → Cara Daughter

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

Loss not allowed.

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Example 3.3 83

Jacob Father → 1/23 → Caleb Son → 4/24 → Unrelated party

Sales price	45,000	Caleb's basis	45,000	No 179/bonus
Jacob's Basis	(50,000)	Depr claimed	(11,941)	
Loss	(5,000)	Basis	33,059	

Loss not allowed. ? recapture

Sold	46,000	Realized Gain	12,941
disallowed loss	(1,000)	recognized gain	11,941

4,000 of disallowed loss lost

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Matching Income & Expense Deductions 83

<p>Payer</p> <div style="background-color: black; color: white; padding: 5px; margin: 5px 0;">Related Party 1</div> <p>Accrual</p>	<p>Deduction limited to amount reported in income</p> <p>Rest deferred until income reported</p>	<p>Payee</p> <div style="background-color: black; color: white; padding: 5px; margin: 5px 0;">Related Party 2</div> <p>Cash</p>
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Example 3.4 84

<p>Payer</p> <div style="background-color: black; color: white; padding: 5px; margin: 5px 0;">Baseline Corp</div> <p>Accrual</p> <p>2024 Accrued 8,300 interest. None paid</p>	<p>INTEREST</p>	<p>Payee</p> <div style="background-color: black; color: white; padding: 5px; margin: 5px 0;">Xavier</div> <p>Cash</p> <p>Owns 100% of stock</p> <p>2024 Since cash basis, no interest income reported</p>
---	-----------------	---

No deduction until paid



23

SHAREHOLDER

Current liabilities	
Loans and notes payable (Note 6)	\$3,732
Accounts payable	7,503
Accrued liabilities	5,531
Accrued rebates, returns, and promotions	2,237
Accrued salaries, wages, and commissions	1,432
Accrued taxes on income	417
Total current liabilities	20,852
Long-term debt (Note 6)	8,120
Deferred taxes on income (Note 8)	1,432
Employee-related obligations (Notes 5 and 13)	7,791
Other liabilities	4,206
	\$42,401

24

Practitioner Note - Relationship Ceases? 84

<p>Payer</p> <p>Related Party 1</p> <p>Accrual</p> 	<p>Deduction limited to amount reported in income</p> <p>→</p> <p>Rest deferred until income reported</p>	<p>Payee</p> <p>Related Party 2</p> <p>Cash</p> 
---	---	--

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


X


25

Issue #2 Transactions between related persons and partnerships 85


Partner

— > 50% —





— Partner —



Owns > 50% of both

Sale or exchange of property

Not 267!
Not 1239!

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

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Proposed Regulations 85

Partnership

Partner


Partner

Partner

Entity?

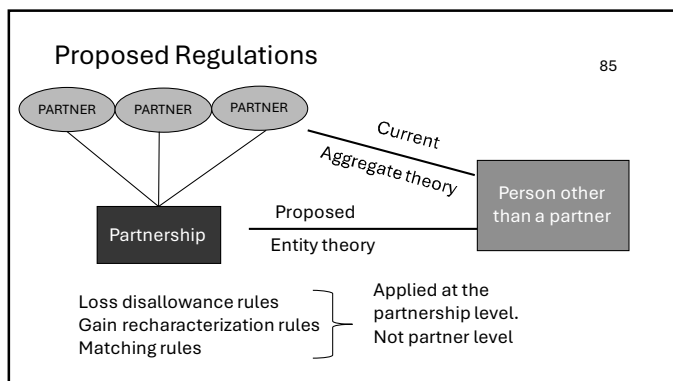
or

Aggregate of individuals?

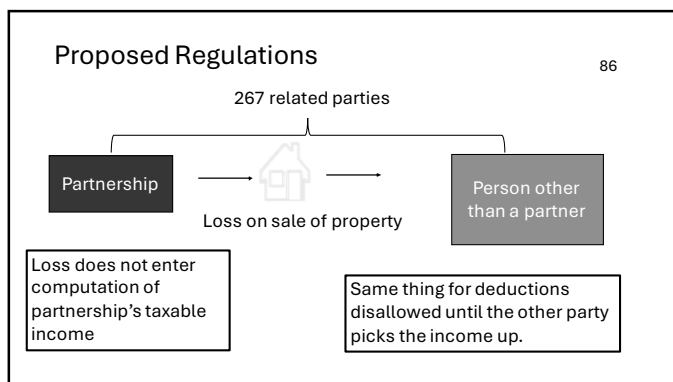


Partnerships have an identity crisis!

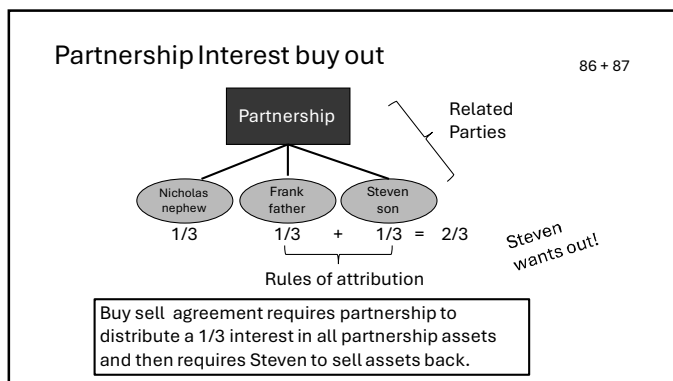
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29



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Partnership Interest buy out 86 + 87

Partnership bought out Steven's interest

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

31

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:

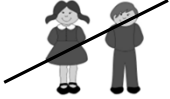
Normal related party rules

Attribution rules and constructive stock ownership rules include brothers and sisters



179 related party rules

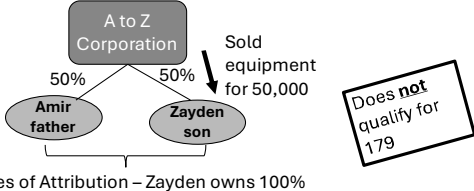
Attribution rules and constructive stock ownership rules **do not** include brothers and sisters



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Example 3.5 179 election – related parties

88



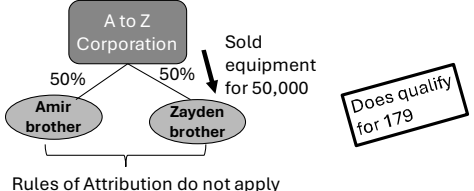
Does **not** qualify for 179

Rules of Attribution – Zayden owns 100%

35

Example 3.5 179 election – related parties

88



Does qualify for 179

Rules of Attribution do not apply

36


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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Take away

Generally speaking, you cannot claim 179 or bonus on assets purchased from related parties

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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?

39

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

50% Sam father

50% George son


(Sale is not between family members)

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

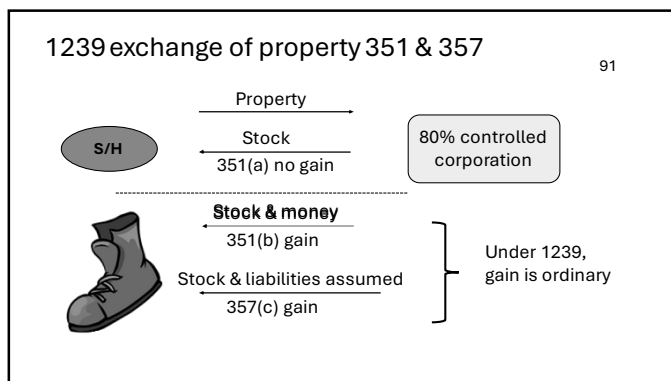
~~ORDINARY!~~

41

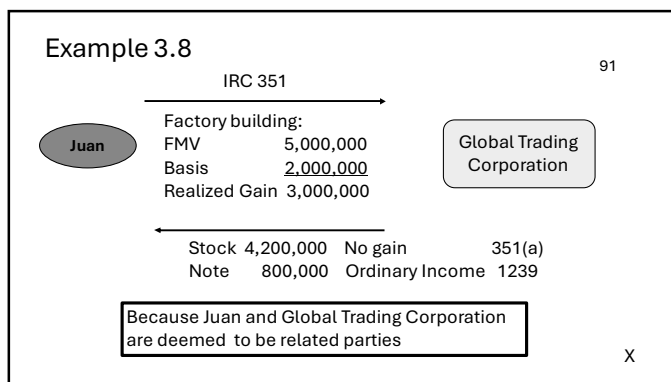
Example 3.7 91

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

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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

45

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

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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

FMV 100,000 Basis 60,000 Deferred 40,000	FMV 100,000 Basis 80,000 Deferred 20,000
--	--

Sells property 7/1/2024

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
<p><u>Original sale</u> Can sell to related parties without establishing that tax avoidance not a principal purpose</p> <p><u>Second disposition</u> Does not accelerate gain recognition if not done for tax avoidance</p>	<p><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</p> <p><u>Second disposition</u> Does not accelerate gain recognition if not done for tax avoidance</p>

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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	<table border="0"> <tr><td>Sales price</td><td>240,000</td></tr> <tr><td>Basis</td><td>(144,000)</td></tr> <tr><td>Gain</td><td>96,000</td></tr> </table>	Sales price	240,000	Basis	(144,000)	Gain	96,000	} Gross profit % = 40%	
Sales price	240,000								
Basis	(144,000)								
Gain	96,000								
	<table border="0"> <tr><td>Down payment</td><td>60,000</td></tr> <tr><td>Promissory note</td><td>180,000</td></tr> <tr><td colspan="2">(60,000/ year for 3 years)</td></tr> </table>	Down payment	60,000	Promissory note	180,000	(60,000/ year for 3 years)		X 40% = 24,000 income for 2023	
Down payment	60,000								
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 <u>(60,000) 2024</u> 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	}	150,000 x .40 = 60,000
2025 60,000 x .40 = 24,000		
2026 60,000 x .40 = 24,000		
48,000		greater

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Example 3.12 continued 98

	GPP	Gain
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% = 12,000
	240,000	96,000

X

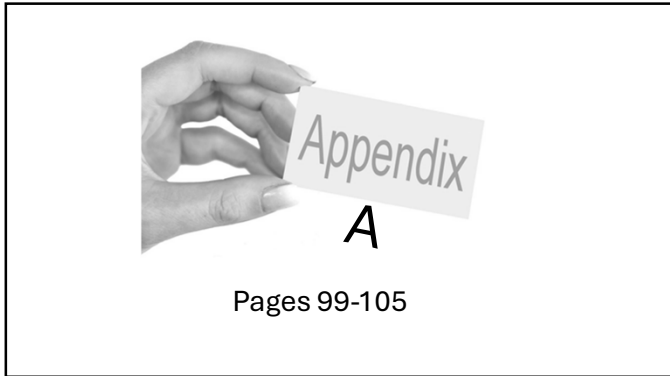
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- Key take aways:**
- Recognize special rules apply to transactions between related parties
 - Look for immediate family members, >50% owned entities and trusts/estates
 - Losses not deductible, but buyer may get to claim the disallowed loss when property sold
 - Accrual entities and cash entities must match income and deduction
 - For this purpose, partnerships are entities

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- Key take aways continued:**
- Gains between related parties (except family) is ordinary
 - Generally speaking, cannot claim 179 or bonus on related party purchases
 - Related parties can do like kind exchanges, but if either party sells prior to 2 years, both parties pick up income
 - Related parties can do installment sales, but if the second party sells within 2 years, first party picks up income
- X

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