

West's

**INTERNAL REVENUE
CODE OF 1986
AND
TREASURY REGULATIONS:
ANNOTATED
AND SELECTED**

1997 Edition

James E. Smith

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AND
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1997 Edition**

by

JAMES E. SMITH, PH.D., C.P.A.

College of William and Mary

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PREFACE

In the study of Federal tax law, the student should be exposed to the statute and the related regulations. This exposure can best be accomplished if the student has his or her copy of the Internal Revenue Code of 1986 and the Treasury Regulations for use inside and outside the classroom. However, cost (over \$50) and size (over 8,000 pages and 5 or 6 volumes) limit this option.

This book is designed to overcome the aforementioned limitations. In addition, the following features are included that make it superior, for educational purposes, to the complete code and regulations.

Annotations. The student is provided with insight into each major topical area of the code. Each such area is preceded by explanation, analysis, and cross-referencing in the form of an Editorial Summary. In order to continue to strengthen this distinguishing feature of the book, the annotations in the 1996 edition have been increased. To make it easy for the student to locate the Editorial Summary that relates to a particular topic, two features are included. First, a List of Editorial Summaries is on page XXXIII. Second, referencing is used in the text to indicate the page where the related Editorial Summary appears.

Selections. Expected frequency of use and the relationship among code sections were the principal criteria used in performing the selection process. Infrequently used and special purpose sections were either partially or completely omitted. The regulations were evaluated in terms of reflecting current law. A sanitizing process was applied which included the omission of out-of-date regulations, the reference to the specific legislation that produced the change, and the specification of the new tax result or the identification of the pertinent code section that contains the new result. Thus, potential student confusion resulting from disagreement between the language of the code and out-of-date regulations is reduced. In addition, footnote disclosure is used to replace code section numbers appearing in the regulations that have been modified by subsequent legislation with the current code section number.

Recent tax legislation. Pending tax legislation for 1996 had not been enacted at the date of this writing. If such tax legislation is enacted, users will be provided with a supplement.

Comprehensive. Coverage is provided on the income, estate, and gift tax law and regulations.

Ease of usage. The annotations provide the student with an appreciation of the relationship among various code sections and assist the student in avoiding the tax trap of a wrong conclusion which frequently results if a code section is viewed in isolation. To aid the professor in making assignments, a list of included code sections and regulation sections is provided. A separate index, by code section, is provided for the income tax, the estate tax, the generation-skipping transfer tax, and the gift tax. Ease of entry in locating a topic is maximized by each topic having multiple entry words or phrases. The

PREFACE

index is arranged with the additional objective of aiding the student in seeing relationships among code sections. Temporary regulations are integrated into the same location as final regulations so the student does not have to turn to different parts of the book while using the regulations for a particular code section. Finally, a separate table of contents is provided for the code and for the regulations.

Flexibility of use. The book can be used as a supplement for any undergraduate or graduate tax course. However, the presence of the annotations makes it equally usable as the primary text in a course in which the professor uses a code and regulations approach in conducting the course. In the supplement format, if only the code is used by the professor, the annotated and abridged code portion of the book can be used.

Indexing. A procedure increasingly used by Congress is to index certain amounts in the code for the effect of inflation. Such indexing includes the individual income tax rates in Sec. 1, earned income credit amounts in Sec. 32, standard deduction in Sec. 63(c), overall limitation on itemized deductions in Sec. 68, qualified transportation fringes in Sec. 132, educational savings bonds exclusion amounts in Sec. 135, personal exemption and dependency deductions in Sec. 151 including the phase out, the limitation on the deduction for luxury automobiles in Sec. 280F, the pension and profit-sharing amounts in Subchapter D of Chapter 1, and interest imputations under Sec. 1274A. These indexed amounts appear with the related code section and also in a table which appears on page XVII.

Depreciation and cost recovery tables. Prior to the 1992 edition, several users had indicated that having the depreciation and cost recovery tables in one location would be useful. As a new feature of the 1992 edition, such tables were included. Based on the positive user feedback, such tables are retained in the 1997 edition and start on page XXI.

Since the book is revised annually, I encourage users to make recommendations that will increase the utility of the book to them and to their students. Every effort will be made to utilize such inputs as the basis for improvement. Several such recommendations are integrated into the current edition.

An expression of appreciation is appropriate for Jennifer Sileo who provided much-needed secretarial assistance. Special thanks are due Nora, Anne, and James, family members without whose support the publication of this book would not have been possible.

JAMES E. SMITH

June, 1996

TABLE OF INDEXED AMOUNTS

1. Tax rates in Sec. 1.

1995 Tax Rate Schedules for Individual Taxpayers

Single—Schedule X				Head of household—Schedule Z			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$0	\$ 23,350	.....15%	\$0	\$0	\$ 31,250	.....15%	\$0
23,350	56,550	\$3,502.50 + 28%	23,350	31,250	80,750	\$4,687.50 + 28%	31,250
56,550	117,950	12,798.50 + 31%	56,550	80,750	130,800	18,547.50 + 31%	80,750
117,950	256,500	31,832.50 + 36%	117,950	130,800	256,500	34,063.00 + 36%	130,800
256,500	_____	81,710.50 + 39.6%	256,500	256,500	_____	79,315.00 + 39.6%	256,500

Married filing jointly or Qualifying widow(er)—Schedule Y-1				Married filing separately—Schedule Y-2			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$0	\$ 39,000	.....15%	\$0	\$0	\$ 19,500	.....15%	\$0
39,000	94,250	\$5,850.00 + 28%	39,000	19,500	47,125	\$2,925.00 + 28%	19,500
94,250	143,600	21,320.00 + 31%	94,250	47,125	71,800	10,660.00 + 31%	47,125
143,600	256,500	36,618.50 + 36%	143,600	71,800	128,250	18,309.25 + 36%	71,800
256,500	_____	77,262.50 + 39.6%	256,500	128,250	_____	38,631.25 + 39.6%	128,250

1995 Tax Rate Schedule for Estates and Trusts

Taxable income Over—	But not over—	The tax is:	of the amount over—
\$0	\$1,550	.....15%	\$0
1,550	3,700	\$ 232.50 + 28%	1,550
3,700	5,600	834.50 + 31%	3,700
5,600	7,650	1,423.50 + 36%	5,600
7,650	_____	2,161.50 + 39.6%	7,650

TABLE OF INDEXED AMOUNTS

1996 Tax Rate Schedules for Individual Taxpayers

Single—Schedule X				Head of household—Schedule Z			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$0	\$24,000	.....15%	\$0	\$0	\$32,150	.....15%	\$0
24,000	58,150	\$3,600.00 + 28%	24,000	32,150	83,050	\$4,822.50 + 28%	32,150
58,150	121,300	13,162.00 + 31%	58,150	83,050	134,500	19,074.50 + 31%	83,050
121,300	263,750	32,738.50 + 36%	121,300	134,500	263,750	35,024.00 + 36%	134,500
263,750		84,020.50 + 39.6%	263,750	263,750		81,554.00 + 39.6%	263,750

Married filing jointly or Qualifying widow(er)—Schedule Y-1				Married filing separately—Schedule Y-2			
If taxable income is: Over—	But not over—	The tax is:	of the amount over—	If taxable income is: Over—	But not over—	The tax is:	of the amount over—
\$0	\$40,100	.....15%	\$0	\$0	\$20,050	.....15%	\$0
40,100	96,900	\$6,015.00 + 28%	40,100	20,050	48,450	\$3,007.50 + 28%	20,050
96,900	147,700	21,919.00 + 31%	96,900	48,450	73,850	10,959.50 + 31%	48,450
147,700	263,750	37,667.00 + 36%	147,700	73,850	131,875	18,833.50 + 36%	73,850
263,750		79,445.00 + 39.6%	263,750	131,875		39,722.50 + 39.6%	131,875

1996 Tax Rate Schedule for Estates and Trusts

If Taxable Income is:	The tax is:
Not over \$1,600	15% of taxable income.
Over \$1,600 but not over \$3,800	\$240.00, plus 28% of the excess over \$1,600.
Over \$3,800 but not over \$5,800	\$856.00, plus 31% of the excess over \$3,800.
Over \$5,800 but not over \$7,900	\$1,476.00, plus 36% of the excess over \$5,800
Over \$7,900	\$2,232.00, plus 39.6% of the excess over \$7,900.

TABLE OF INDEXED AMOUNTS

2. Earned income credit amounts in Sec. 32.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Maximum amount eligible for credit:			
One child	\$ 6,000	\$ 6,330	\$ 6,160
Two or more	8,425	8,890	8,640
No children	4,000	4,220	4,100
Credit percentage:			
One child	34.0%	34.0%	34.0%
Two or more	40.0%	40.0%	36.0%
No children	7.65%	7.65%	7.65%
Phaseout of credit begins:			
One child	\$ 11,000	\$ 11,610	\$ 11,290
Two or more	11,000	11,610	11,290
No children	5,000	5,280	5,130
Phaseout of credit ends:			
One child	\$ 23,766	\$ 25,078	\$ 24,396
Two or more	27,002	28,495	26,673
No children	9,000	9,500	9,230
Phaseout percentage:			
One child	15.98%	15.98%	15.98%
Two or more	21.06%	21.06%	20.22%
No children	7.65%	7.65%	7.65%

3. Standard deduction in Sec. 63(c).

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Category			
Single	\$ 3,000	\$ 4,000	\$ 3,900
Head of household	4,400	5,900	5,750
Married filing jointly and surviving spouse	5,000	6,700	6,550
Married filing separately	2,500	3,350	3,275
Additional standard deduction for blind or aged	600	800	750
	or	or	or
	750	1,000	950

4. Overall limitation on itemized deductions under Sec. 68.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Married filing separately	\$ 50,000	\$ 58,975	\$ 57,350
Other than married filing separately	100,000	117,950	114,700

5. Qualified transportation fringe exclusion.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Transportation in a commuter highway vehicle and transit pass	\$ 60	\$ 65	\$ 60
Qualified parking	\$ 155	\$ 165	\$ 160

6. Education savings bonds exclusion in Sec. 135.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
AGI ceiling			
Joint return	\$ 60,000	\$ 65,250	\$ 63,450
Not a joint return	40,000	43,500	42,300
Phase-out range			
Joint return	\$ 30,000	\$ 30,000	\$ 30,000
Not a joint return	15,000	15,000	15,000

TABLE OF INDEXED AMOUNTS

7. Personal exemption and dependency deductions in Sec. 151.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
	\$ 2,000	\$ 2,550	\$ 2,500

8. Threshold amounts for phase-out of personal exemptions under Sec. 151(d)(3).

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Single	\$ 100,000	\$ 117,950	\$ 114,700
Head of household	125,000	147,450	143,350
Married filing jointly and surviving spouse	150,000	176,950	172,050
Married filing separately	75,000	88,475	86,025

9. Limitation on deduction for luxury automobiles in Sec. 280F.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Year			
1st	\$ 2,560	\$ 3,060	\$ 3,060
2nd	4,100	4,900	4,900
3rd	2,450	2,950	2,950
Each succeeding year	1,475	1,775	1,775

10. Statutory amounts for pension and profit-sharing plans.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Item			
Maximum annual benefits payable for a defined benefit plan	\$ 90,000	\$ 120,000	\$ 120,000
Maximum annual contribution to a defined contribution plan	30,000	30,000	30,000
Definition of a highly compensated employee	50,000	66,000	66,000
	or	or	or
	75,000	100,000	100,000
Annual compensation ceiling	150,000	150,000	150,000
Section 401(k) plan ceiling	7,000	9,500	9,240
SEP compensation minimum	300	400	400
Tax credit ESOP distribution ceiling	100,000	135,000	132,000
	or	or	or
	500,000	690,000	670,000
Qualified retirement plan excess distribution threshold	112,500	155,000	150,000
Officer in top-heavy plan	45,000	60,000	60,000

11. Interest imputations under Sec. 1274A.

	Amount per Code	Indexed 1996 Amount	Indexed 1995 Amount
Lower interest rate—principle amount ceiling on transactions to which applicable	\$ 2,800,000	\$ 3,622,500	\$ 3,523,600
Election to use cash method—principal amount ceiling on transactions where election can be made	\$ 2,000,000	\$ 2,587,500	\$ 2,516,900

DEPRECIATION AND COST RECOVERY TABLES

TABLE 1

ACRS Statutory Percentages for Property Other Than 15-Year Real Property,
18-Year Real Property, or 19-Year Real Property
Assuming Half-Year Convention

**For Property Placed in Service after December 31, 1980,
and before January 1, 1987**

The applicable percentage for the
class of property is:

Recovery Year	3-Year	5-Year	10-Year	15-Year Public Utility
1	25	15	8	5
2	38	22	14	10
3	37	21	12	9
4		21	10	8
5		21	10	7
6			10	7
7			9	6
8			9	6
9			9	6
10			9	6
11				6
12				6
13				6
14				6
15				6

DEPRECIATION AND COST RECOVERY TABLES

TABLE 2
MACRS Accelerated Depreciation for Personal Property
Assuming Half-Year Convention

For Property Placed in Service after December 31, 1986						
Recovery Year	3-Year (200% DB)	5-Year (200% DB)	7-Year (200% DB)	10-Year (200% DB)	15-Year (150% DB)	20-Year (150% DB)
1	33.33	20.00	14.29	10.00	5.00	3.750
2	44.45	32.00	24.49	18.00	9.50	7.219
3	14.81 *	19.20	17.49	14.40	8.55	6.677
4	7.41	11.52 *	12.49	11.52	7.70	6.177
5		11.52	8.93 *	9.22	6.93	5.713
6		5.76	8.92	7.37	6.23	5.285
7			8.93	6.55 *	5.90 *	4.888
8			4.46	6.55	5.90	4.522
9				6.56	5.91	4.462 *
10				6.55	5.90	4.461
11				3.28	5.91	4.462
12					5.90	4.461
13					5.91	4.462
14					5.90	4.461
15					5.91	4.462
16					2.95	4.461
17						4.462
18						4.461
19						4.462
20						4.461
21						2.231

* Switchover to straight-line depreciation.

DEPRECIATION AND COST RECOVERY TABLES

TABLE 3
MACRS Accelerated Depreciation for Personal Property
Assuming Mid-Quarter Convention

For Property Placed in Service after December 31, 1986 (Partial Table*)				
Recovery Year	First Quarter	<u>3-Year</u>		
		Second Quarter	Third Quarter	Fourth Quarter
1	58.33	41.67	25.00	8.33
2	27.78	38.89	50.00	61.11
Recovery Year	First Quarter	<u>5-Year</u>		
		Second Quarter	Third Quarter	Fourth Quarter
1	35.00	25.00	15.00	5.00
2	26.00	30.00	34.00	38.00
Recovery Year	First Quarter	<u>7-Year</u>		
		Second Quarter	Third Quarter	Fourth Quarter
1	25.00	17.85	10.71	3.57
2	21.43	23.47	25.51	27.55

* The figures in this table are taken from the official tables that appear in Rev.Proc. 87-57, 1987-2 C.B. 687. Because of their length, the complete tables are not presented.

DEPRECIATION AND COST RECOVERY TABLES

TABLE 4
ACRS Statutory Percentages for 15-Year Real Property

**For Property Placed in Service after December 31, 1980,
and before January 1, 1987
15-Year Real Property: Low-Income Housing**

If the recovery year is:	And the month in the first recovery year the property is placed in service is:											
	1	2	3	4	5	6	7	8	9	10	11	12
The applicable percentage is (use the column for the month in the first year the property is placed in service):												
1	13	12	11	10	9	8	7	6	4	3	2	1
2	12	12	12	12	12	12	12	13	13	13	13	13
3	10	10	10	10	11	11	11	11	11	11	11	11
4	9	9	9	9	9	9	9	9	10	10	10	10
5	8	8	8	8	8	8	8	8	8	8	8	9
6	7	7	7	7	7	7	7	7	7	7	7	7
7	6	6	6	6	6	6	6	6	6	6	6	6
8	5	5	5	5	5	5	5	5	5	5	6	6
9	5	5	5	5	5	5	5	5	5	5	5	5
10	5	5	5	5	5	5	5	5	5	5	5	5
11	4	5	5	5	5	5	5	5	5	5	5	5
12	4	4	4	5	4	5	5	5	5	5	5	5
13	4	4	4	4	4	4	5	4	5	5	5	5
14	4	4	4	4	4	4	4	4	4	5	4	4
15	4	4	4	4	4	4	4	4	4	4	4	4
16	—	—	1	1	2	2	2	3	3	3	4	4

DEPRECIATION AND COST RECOVERY TABLES

TABLE 4 (Continued)

**For Property Placed in Service after December 31, 1980,
and before March 16, 1984
15-Year Real Property: Other Than Low-Income Housing**

If the
recovery
year is:

And the month in the first recovery year
the property is placed in service is:

1 2 3 4 5 6 7 8 9 10 11 12

The applicable percentage is (use the column for the
month in the first year the property is placed in service):

1	12	11	10	9	8	7	6	5	4	3	2	1
2	10	10	11	11	11	11	11	11	11	11	11	12
3	9	9	9	9	10	10	10	10	10	10	10	10
4	8	8	8	8	8	8	9	9	9	9	9	9
5	7	7	7	7	7	7	8	8	8	8	8	8
6	6	6	6	6	7	7	7	7	7	7	7	7
7	6	6	6	6	6	6	6	6	6	6	6	6
8	6	6	6	6	6	6	5	6	6	6	6	6
9	6	6	6	6	5	6	5	5	5	6	6	6
10	5	6	5	6	5	5	5	5	5	5	6	5
11	5	5	5	5	5	5	5	5	5	5	5	5
12	5	5	5	5	5	5	5	5	5	5	5	5
13	5	5	5	5	5	5	5	5	5	5	5	5
14	5	5	5	5	5	5	5	5	5	5	5	5
15	5	5	5	5	5	5	5	5	5	5	5	5
16	—	—	1	1	2	2	3	3	4	4	4	5

DEPRECIATION AND COST RECOVERY TABLES

TABLE 5
ACRS Cost Recovery Table for 18-Year Real Property

For Property Placed in Service after June 22, 1984, and before May 9, 1985
18-Year Real Property (18-Year 175% Declining Balance)
(Assuming Mid-Month Convention)

If the recovery year is:	And the month in the first recovery year the property is placed in service is:											
	1	2	3	4	5	6	7	8	9	10	11	12
The applicable percentage is (use the column for the month in the first year the property is placed in service):												
1	9	9	8	7	6	5	4	4	3	2	1	0.4
2	9	9	9	9	9	9	9	9	9	10	10	10.0
3	8	8	8	8	8	8	8	8	9	9	9	9.0
4	7	7	7	7	7	8	8	8	8	8	8	8.0
5	7	7	7	7	7	7	7	7	7	7	7	7.0
6	6	6	6	6	6	6	6	6	6	6	6	6.0
7	5	5	5	5	6	6	6	6	6	6	6	6.0
8	5	5	5	5	5	5	5	5	5	5	5	5.0
9	5	5	5	5	5	5	5	5	5	5	5	5.0
10	5	5	5	5	5	5	5	5	5	5	5	5.0
11	5	5	5	5	5	5	5	5	5	5	5	5.0
12	5	5	5	5	5	5	5	5	5	5	5	5.0
13	4	4	4	5	4	4	5	4	4	4	5	5.0
14	4	4	4	4	4	4	4	4	4	4	4	4.0
15	4	4	4	4	4	4	4	4	4	4	4	4.0
16	4	4	4	4	4	4	4	4	4	4	4	4.0
17	4	4	4	4	4	4	4	4	4	4	4	4.0
18	4	3	4	4	4	4	4	4	4	4	4	4.0
19	—	1	1	1	2	2	2	3	3	3	3	3.6

DEPRECIATION AND COST RECOVERY TABLES

TABLE 6
ACRS Cost Recovery Table for 19-Year Real Property

For Property Placed in Service after May 8, 1985, and before January 1, 1987
19-Year Real Property (19-Year 175% Declining Balance)
(Assuming Mid-Month Convention)

If the recovery year is:	And the month in the first recovery year the property is placed in service is:											
	1	2	3	4	5	6	7	8	9	10	11	12
The applicable percentage is (use the column for the month in the first year the property is placed in service):												
1	8.8	8.1	7.3	6.5	5.8	5.0	4.2	3.5	2.7	1.9	1.1	0.4
2	8.4	8.5	8.5	8.6	8.7	8.8	8.8	8.9	9.0	9.0	9.1	9.2
3	7.6	7.7	7.7	7.8	7.9	7.9	8.0	8.1	8.1	8.2	8.3	8.3
4	6.9	7.0	7.0	7.1	7.1	7.2	7.3	7.3	7.4	7.4	7.5	7.6
5	6.3	6.3	6.4	6.4	6.5	6.5	6.6	6.6	6.7	6.8	6.8	6.9
6	5.7	5.7	5.8	5.9	5.9	5.9	6.0	6.0	6.1	6.1	6.2	6.2
7	5.2	5.2	5.3	5.3	5.3	5.4	5.4	5.5	5.5	5.6	5.6	5.6
8	4.7	4.7	4.8	4.8	4.8	4.9	4.9	5.0	5.0	5.1	5.1	5.1
9	4.2	4.3	4.3	4.4	4.4	4.5	4.5	4.5	4.5	4.6	4.6	4.7
10	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
11	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
12	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
13	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
14	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
15	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
16	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
17	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
18	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
19	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
20	0.2	0.5	0.9	1.2	1.6	1.9	2.3	2.6	3.0	3.3	3.7	4.0