

**1988
EDITION**

WEST'S

INTERNAL REVENUE
CODE OF 1986

AND

TREASURY
REGULATIONS:
ANNOTATED AND
SELECTED

JAMES E. SMITH

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CODE OF 1986
AND
TREASURY REGULATIONS:
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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.

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 A sanitizing process was applied which included the omission of out-of-date regulations, the reference to the specific legislation that produced the change, and the specification of the new tax result or the identification of the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 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.

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. 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 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

PREFACE

only the code is used by the professor, the annotated and abridged code portion of the book can be used.

Since the book will be 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.

An expression of appreciation is appropriate for Liane Meacham and Eddie Koch 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, 1987

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INTERNAL REVENUE CODE OF 1986

INTERNAL REVENUE TITLE

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1. Normal taxes and surtaxes.
2. Tax on self-employment income.*
3. Withholding of tax on nonresident aliens and foreign corporations.*

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4. Rules applicable to recovery of excessive profits on government contracts.*
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CHAPTER 1—NORMAL TAXES AND SURTAXES

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- M. Regulated investment companies and real estate investment trusts.*
- N. Tax based on income from sources within or without the United States.
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- P. Capital gains and losses.
- Q. Readjustment of tax between years and special limitations.
- [R. Repealed]
- S. Tax treatment of S corporations and their shareholders.
- T. Cooperatives and their patrons.*
- U. General stock ownership corporations.*
- V. Title 11 cases.*

SUBCHAPTER A—DETERMINATION OF TAX LIABILITY

Part

- I. Tax on individuals.
- II. Tax on corporations.
- III. Changes in rates during a taxable year.
- IV. Credits against tax.
- [V. Repealed]
- VI. Alternative minimum tax.
- VII. Environmental tax.

locates the taxable income in the appropriate taxable income column in the table, and the tax liability is the related tax liability amount in the tax liability column. The tax table must be used unless the taxpayer is not eligible to use it. The tax rates are to be indexed for the effect of inflation [see Sec. 1(f)].

In calculating the individual tax liability, the following must be considered:

1. The effective tax rate may be greater than the stated rate due to the phase-outs of the 15% rate and personal exemptions [see Sec. 1(g)].
2. For a child under age 14 with unearned income, the parents' rates may apply [see Sec. 1(i)].
3. For certain capital gains, a maximum rate may apply [see Sec. 1(j)].
4. The alternative minimum tax may apply rather than the regular income tax [see Sec. 55].
5. The filing status of the taxpayer affects the tax rates [see Secs. 1–2].

Section 1 also contains the income tax rates for estates and trusts.

Editorial Summary

Tax Rates

Subchapter A of Chapter 1 (Secs. 1–15)

Sections 1–15 provide the tax rates for the individual taxpayer and the corporate taxpayer. Rates are not provided for a partnership because the partnership is a conduit (i.e., a tax reporter rather than a taxpayer) [see Sec. 701].

For the individual taxpayer, two methods are provided for applying the tax rates to taxable income to calculate the tax liability. The first method is to use the tax rate schedule under which the taxpayer applies the statutory tax rates to taxable income [see Sec. 1]. The second method is to use the tax table [see Sec. 3]. In this case, the taxpayer

* Omitted.

Special tax rates apply for the small corporation. These beneficial rates are phased out as the taxable income of the corporation increases above \$100,000 [see Sec. 11(b)]. Related items that may affect the corporate income tax liability include the following:

1. The alternative minimum tax [see Sec. 55].
2. The accumulated earnings tax [see Sec. 531].
3. The personal holding company tax [see Sec. 541].
4. The tax rate limitations imposed on corporations that are members of a controlled group [see Sec. 1561].

5. The ability to reduce the effective tax rate through the filing of a consolidated tax return [see Sec. 1501].

6. The alternative tax on certain capital gains if the regular corporate tax rates should be increased by Congress [see Sec. 1201(a)].

As is the case with the partnership, certain corporations (i.e., S corporations) generally are not subject to taxation (see Sec. 1361). Instead, the tax liability is levied at the shareholder level (see Sec. 1366).

PART I—TAX ON INDIVIDUALS

§ 1. Tax imposed

(a) Married individuals filing joint returns and surviving spouses.—There is hereby imposed on the taxable income of—

(1) every married individual (as defined in section 7703) who makes a single return jointly with his spouse under section 6013, and

(2) every surviving spouse (as defined in section 2(a)),

a tax determined in accordance with the following table:

If taxable income is	The tax is:
Not over \$29,750	15% of taxable income.
Over \$29,750	\$4,462.50, plus 28% of the excess over \$29,750.

(b) Heads of households.—There is hereby imposed on the taxable income of every head of a

household (as defined in section 2(b)) a tax determined in accordance with the following table:

If taxable income is	The tax is:
Not over \$23,900	15% of taxable income.
Over \$23,900	\$3,585, plus 28% of the excess over \$23,900.

(c) Unmarried individuals (other than surviving spouses and heads of households).—There is hereby imposed on the taxable income of every individual (other than a surviving spouse as defined in

section 2(a) or the head of a household as defined in section 2(b)) who is not a married individual (as defined in section 7703) a tax determined in accordance with the following table:

If taxable income is	The tax is:
Not over \$17,850	15% of taxable income.
Over \$17,850	\$2,677.50, plus 28% of the excess over \$17,850.

(d) Married individuals filing separate returns.—There is hereby imposed on the taxable income of every married individual (as defined in section

7703) who does not make a single return jointly with his spouse under section 6013, a tax determined in accordance with the following table:

If taxable income is	The tax is:
Not over \$14,875	15% of taxable income.
Over \$14,875	\$2,231.25, plus 28% of the excess over \$14,875.

(e) Estates and trusts.—There is hereby imposed on the taxable income of—

(1) every estate, and

(2) every trust,

taxable under this subsection a tax determined in accordance with the following table: