Fishing Information Newsletter

News You Can Use from the Internal Revenue Service

Volume 3, Issue 01 **Circulation 421** **January 2001**

Message from the Coordinator

Happy New Year!!

The beginning of a new year is an excellent time to organize your records in anticipation of timely filing tax returns and to arrange your income and expense records so that next year at this time it will be easy to pull everything together.

For those of you with internet access, I would encourage you to visit the STAWRS (Simplified Tax and Wage Reporting System) home page (www.tax.gov). This web site has links to the Department of Labor, Internal Revenue Service, Social Security Administration and the Small Business Administration. It bills itself as the "One Stop Guide" and is very useful to tax practitioners and those taxpayers starting a new business.

As I have mentioned in the past, the content of this newsletter is largely dependent upon your questions and comments. Please send us your topic ideas and questions and we will make certain they are addressed in future issues.

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Please send us your topic ideas and questions….

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Transfer of Limited Entry Permits Between Spouses

The following question was submitted by one of our readers:

If spouses transfer an amortizable limited entry permit between themselves, what, if any, change in the permit basis, and thus amortization, occurs?

In order to make the following response a little easier to follow, assume that the husband originally owned a limited entry fishing permit and transferred it to his wife.

Under Internal Revenue Code section 1041, no gain or loss is recognized on a transfer of property from an individual to a spouse. In addition, the property is treated as if acquired by the transferee (wife) by gift and the basis of the transferee in the property is the same as the adjusted basis of the transferor (husband). So, if a husband transfers a fishing permit, that has a basis to the husband of $100,000, to his wife, there will be no gain or loss on the transfer. In addition, the wife's basis in the fishing permit will the same as the husband's basis, or $100,000. The wife's basis in the permit will be $100,000 regardless of the amount she may have paid to the husband for the permit (assuming the transfer was in the form of a sale as opposed to a gift).

Section 1041 applies to any transfer of property between spouses regardless of whether the transfer is a gift or is a sale or exchange between spouses acting at arm's length. A divorce or legal separation need not be contemplated between the spouses at the time of the transfer nor must a divorce or legal separation ever occur.

If the purpose of this transfer is to try to convert a fishing permit that doesn't qualify for section 197 amortization because it was purchased prior to the effective date of the section 197 law change, into one that does, this will not be possible due to the anti-abuse rules

The fishing permit in the wife's hands will remain unamortizable. It will also have the same basis as the husband's basis immediately prior to transfer.

If an individual sells their limited entry permit on the open market, could you review the process to find the portions that are capital gain/loss, and ordinary income? How should these be reported?

In order to answer your question and illustrate how the capital gain and ordinary income portions are determined, the following facts will be used:

Taxpayer purchased and placed in service a limited entry fishing permit on July 1, 1995 (a year in which section 197 amortization is applicable), for $150,000. The taxpayer amortized the permit for 6 months in 1995 and claimed a $5,000 deduction ($150,000/15 years = $10,000/year x 1/2 year = $5,000). The taxpayer claimed $10,000 section 197 amortization in each year for the 1996, 1997, 1998, and 1999 tax years. On October 1, 2000, the taxpayer sold the permit for $160,000. The taxpayer will be eligible to claim amortization of $7,500 for the 2000 tax year (3/4 of the full year amortization). The total amortization for the 1995 through 2000 years is $52,500 ($5,000 + $40,000 + $7,500 = $52,500).

At the time of sale, the taxpayer's basis in the fishing permit is $97,500. This is computed by subtracting the prior section 197 amortization from the original cost of the permit ($150,000 - $52,500 = $97,500). The total gain is $62,500, which is computed by subtracting the basis from the selling price ($160,000 - $97,500 = $62,500). Of the $62,500 gain, the first $52,500 will be ordinary income (limited to the amount of section 197 amortization previously claimed), and the $10,000 excess will be capital gain. If the taxpayer sells the permit for $140,000 instead of $160,000, the total gain would be $42,500, all of which would be ordinary income due to the section 197 amortization recapture rules.

The sale of a fishing permit is reported on Form 4797 in part III. If the form is properly completed, the $10,000 capital gain will be carried forward to line 6 of the Form 4797, and the $52,500 ordinary income will be carried forward to line 13 of the Form 4797. This will result in the $10,000 being treated as capital gain and the $52,500 being treated as ordinary income.

Cash Payments to Purchase Fish

(This article originally appeared in the October 1999 issue of the Fishing Information Newsletter. It is being reprinted in this issue because it has come to our attention that several taxpayers are not complying with the provisions of Internal Revenue Code Section 6050R.)

If you are a fish wholesaler, retailer, restaurant owner, marine worm dealer, or any other type of business that buys fish for resale directly from the fisherman, using cash, there are tax regulations that come into play.

One of the provisions in the Small Business Job Protection Act of 1996 created Internal Revenue Code Section 6050R, *Returns Relating to Certain Purchases of Fish*. The Code Section requires that if you purchase **fish** from a **person** who is in the business of catching fish and you pay $600 in **cash** during the course of the calendar year to this person, you must report this information to the IRS. The effective date for 6050R was for all payments made after December 31, 1997.

Fish

The term **fish** includes fish, shellfish (including clams and mussels), crustacea (such as lobster, crab, shrimp, sponge, seaweed, marine worms, or other aquatic forms of animal or vegetable life).

Person

The term **person** includes an individual, a trust, an estate, a partnership, an association, a company, and a corporation.

Cash

The definition of **cash** is currency, cashiers' checks, bank drafts, travelers' checks and money orders. (Cash does not include personal checks and business checks).

In order to comply with information reporting provisions, you are required to obtain or maintain the following:

- Complete name, addresses, and tax identification number of each person to whom you pay cash for the product. The information should be captured on Form W-9, *Request for Taxpayer Identification Number and Certification*, at the time of the initial cash transaction.

- Maintain records of each payment to these persons. Form 1099 MISC, *Miscellaneous Income*, is required to be filed with the IRS for each person to whom you paid more than $600 in cash for the purchase of fish. The total amount paid to the person is reflected in item 7, "Non-employee Compensation".

Sale of Fish for Cash

As you've learned from the previous article, the tax law requires the buyer to issue a Form 1099 MISC, *Miscellaneous Income*, to a fisherman for certain cash sales.

Same Buyer

As the fisherman, if all your cash sales are to the same buyer, then your gross receipts should equal the amount shown on the Form 1099 MISC. At the end of the calendar year, you should compare the 1099 MISC amount with the amount shown in your cash sales journal (provided you are a cash basis taxpayer).

Multiple Buyers

As the fisherman, if your cash sales are to more than one buyer, then the amount shown in your cash sales journal should be compared to the total of the amounts shown on all 1099 MISC forms.

Multiple Buyers — Cash and Checks

As the fisherman, if you sell for cash to some buyers and checks for others, then good recordkeeping becomes extremely important. You must keep track of cash sales and check sales. At the end of the year, the amounts must be reconciled to ensure the correct amount has been reported.

Reselling Share of the Catch

If you are a boatowner and have a crewmember or sternsman and pay them a percentage of the catch, the above explanations should apply.

As the crewmember or sternman who is given a share of the catch to sell, you may be faced with a potential recordkeeping problem. The crewmember/sternman who sells their share of the catch for cash would be issued a 1099 MISC from the buyer AND one from the boat owner. However, the 1099s could be for different amounts. Because both Forms 1099 need to be filed with the IRS, in this instance Agency records would indicate twice the amount actually received by the seller.

The easiest way to remedy potential problems is to sell the product and receive payment by check, not cash.

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IRS
Department of the Treasury
Internal Revenue Service
Publication **3432 (01/01)**
Catalog Number **26188F**
www.irs.gov