status shall be determined under section 153 and the regulations thereunder.

[T.D. 7446, 41 FR 55337, Dec. 20, 1976]

§ 1.1348–2 Computation of the fifty-percent maximum tax on earned income.

(a) *Computation of tax for taxable years beginning after 1971.* If, for a taxable year beginning after December 31, 1971, an individual has earned taxable income (as defined in paragraph (d) of this section) which exceeds the applicable amount in column (1) of table A, the tax imposed by section 1 for such year shall be the sum of:

(1) The applicable amount in column (2) of table A.

(2) 50 percent of the amount by which earned taxable income exceeds the applicable amount in column (1) of table A, and

(3) The amount by which the tax imposed by chapter 1 on the entire taxable income exceeds a tax so computed on earned taxable income, such computations to be made without regard to section 1348 or 1301.

TABLE A

Status	(1)	(2)
Married individuals filing joint returns and surviving spouses	$52,000	$18,060
Heads of households	38,000	12,240
Unmarried individuals other than surviving spouses and heads of households	38,000	13,290
Trusts and estates	26,000	9,030

(b) *Computation of tax for taxable years beginning in 1971.* If, for a taxable year beginning after December 31, 1970, and before January 1, 1972, an individual has earned taxable income (as defined in paragraph (d) of this section) which exceeds the applicable amount in column (1) of table B, the tax imposed by section 1 for such year shall be the sum of:

(1) The applicable amount in column (2) of table B,

(2) 60 percent of the amount by which earned taxable income exceeds the applicable amount in column (1) of table B, and

(3) The amount by which the tax imposed by chapter 1 on the entire taxable income exceeds a tax so computed on earned taxable income, such computations to be made without regard to section 1348 or 1301.

TABLE B

Status	(1)	(2)
Married individuals filing joint returns and surviving spouses	$100,000	$45,180
Heads of households	70,000	30,260
Unmarried individuals other than surviving spouses and heads of households	50,000	20,190
Trusts and estates	50,000	22,590

(c) *Short taxable periods.* If a taxpayer is required under section 443(a)(1) to make a return for a period of less than 12 months, the tax under section 1348 and this section shall be determined by placing his taxable income, earned net income, adjusted gross income, and items of tax preference on an annual basis in accordance with section 443 and the regulations thereunder. If a taxable year referred to in paragraph (d)(3)(i)(*a*) of this section is a period of less than 12 months for which a return is required under section 443(a)(1), the average described in such paragraph shall also be determined by placing the items of tax preference for such period on an annual basis in accordance with section 443 and the regulations thereunder. If a return for a period of less than 12 months is required under section 443(a)(3) for any taxable year referred to in paragraph (d)(3)(i)(*a*) of this section, section 1348 and this section shall not apply unless such period is reopened by the taxpayer as provided by section 6851(b).

(d) *Earned taxable income*—(1) *In general.* For purposes of section 1348 and this section, the term *earned taxable income* means the excess of (i) the portion of taxable income which, under subparagraph (2) of this paragraph, is attributable to earned net income over (ii) the tax preference offset (as defined in subparagraph (3) of this paragraph). For purposes of computing the alternative tax under section 1201, earned taxable income shall not exceed the excess of taxable income over 50 percent of the net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977).

(2) *Taxable income attributable to earned net income.* The portion of taxable income which is attributable to

earned net income shall be determined by multiplying taxable income by a fraction (not exceeding one), the numerator of which is earned net income, and the denominator of which is adjusted gross income. For purposes of this subparagraph the term *earned net income* means the excess of the total of earned income (as defined in § 1.1343–(a)) over the total of any deductions which are required to be taken into account under section 62 in determining adjusted gross income and are properly allocable to or chargeable against earned income. Deductions are properly allocable to or chargeable against earned income if, and to the extent that, they are allowable in respect of expenses paid or incurred in connection with the production of earned income and have not been taken into account in determining the net profits of a trade or business in which both personal services and capital are material income producing factors (as defined in § 1.1348–3(a)(3)). Except as otherwise provided, deductions properly allocable to or chargeable against earned income include:

(i) Deductions attributable to a trade or business from which earned income is derived, except that if less than all the gross income from a trade or business constitutes earned income, only a ratable portion of the deductions attributable to such trade or business is allowable in respect of expenses paid or incurred in connection with the production of earned income,

(ii) Deductions consisting of expenses paid or incurred in connection with the performance of services as an employee,

(iii) The deductions described in section 62(7) and allowable by sections 404 and 405(c),

(iv) The deduction allowable by section 217,

(v) The deduction allowable by section 1379(b)(3), and

(vi) A net operating loss deduction to the extent that the net operating losses carried to the taxable year are properly allocable to or chargeable against earned income.

A net operating loss carried to the taxable year is properly allocable to or chargeable against earned income in such year to the extent of the excess (if any) of the deductions for the loss year which are properly allocable to or chargeable against earned income and which are allowable under section 172(d) in determining a net operating loss, over the earned income for the loss year. If the excess described in the preceding sentence is less than the entire net operating loss, such excess and the balance of such loss shall be deemed to reduce taxable income ratably for any taxable year to which such loss may be carried. See examples (3) and (4) in subparagraph (4) of this paragraph.

(3) *Tax preference offset.* (i) For purposes of subparagraph (1) of this paragraph, the *tax preference offset* is the amount by which the greater of:

(A) The average of the taxpayer's items of tax preference for the taxable year and the four preceding taxable years, or

(B) The taxpayer's items of tax preference for the taxable year,

exceeds $30,000.

(ii) The items of tax preference to be taken into account under subdivision (i) of this subparagraph for any taxable year shall be those items of tax preference referred to in section 57(a) and the regulations thereunder for the taxable year, but excluding any amount not taken into account in computing the tax under section 56(a) and the regulations thereunder for such taxable year. The items of tax preference to be taken into account by an individual for any taxable year in which such individual is or was a nonresident alien shall not include items of tax preference which are not effectively connected with the conduct of a trade or business within the United States.

(iii) Taxable years ending before January 1, 1970 shall not be included in computing the average described in subdivision (i)(A) of this subparagraph. Thus, for example, the tax preference offset for a taxable year ending on December 31, 1973, is the amount by which the average of the taxpayer's items of tax preference for 1970, 1971, 1972, and 1973, or the taxpayer's items of tax preference for 1973, whichever is greater, exceeds $30,000. Taxable years during which the taxpayer was not in existence shall not be included in computing the average described in subdivision (i)(A) of this subparagraph. A fractional part of a year which is treated as a taxable year under sections 441(b) and 7701(a)(23) shall be treated as a taxable year for purposes of this section for special rules if a taxable year referred to in subdivision (i)(A) of this subparagraph is a period of less than 12 months for which a return is required under section 443(a)(1).

(iv) If for the current taxable year the taxpayer and his spouse (or the estate of such spouse) file a joint return together, the items of tax preference for a preceding taxable year taken into account under subdivision (i)(A) of this subparagraph shall be the sum of the items of tax preference of the taxpayer and his spouse for such preceding year even though a joint return was not, or could not have been, filed by the taxpayer and such spouse for such preceding taxable year. If for the current taxable year the taxpayer (A) is no longer married to a spouse to whom he was married for a preceding taxable year taken into account under subdivision (i)(A) of this subparagraph and files a return as a single person, head of household, or surviving spouse for such current taxable year, or (B) is married to a spouse other than the spouse to whom he was married for a preceding taxable year taken into account under subdivision (i)(A) of this subparagraph, his items of tax preference shall be computed as if he were not married during such preceding taxable year.

(v) The sum of the items of tax preference of an estate or trust shall, for purposes of this paragraph, be apportioned between the estate or trust and the beneficiary in the manner and to the extent provided by section 58(c)(1) and the regulations thereunder.

(vi) If an item of gross income in respect of a decedent is includible in the gross income of a taxpayer and is treated as earned income in the hands of the taxpayer by reason of §1.1348–3(a)(4), the items of tax preference for a taxable year taken into account under subdivision (i) of this subparagraph shall be the sum of the taxpayer's items of tax preference for such taxable year and the decedent's items of tax preference for any taxable year of the decedent (including a short taxable year described in section 441(b)(3)) which ends with or within such taxable year of the taxpayer. For purposes of this subdivision, if a taxpayer (such as the estate of the decedent or a testamentary trust created by the decedent) has not been in existence for the number of preceding taxable years specified in subdivision (i)(A) or (iii) of this subparagraph, the items of tax preference for preceding taxable years taken into account shall be the taxpayer's items of tax preference for each of its preceding taxable years plus the decedent's items of tax preference for that number of the most recent taxable years of the decedent ending prior to the taxpayer's earliest taxable year which, when added to the taxpayer's preceding taxable years, equals such number of preceding taxable years specified in subdivision (i)(A), or (iii). The increase, if any, in the taxpayer's tax preference offset computed under this subdivision shall not exceed the amount by which the taxpayer's taxable income attributable to earned net income, computed as provided in §1.1348–2(d)(2) and including the item of gross income in respect of a decedent, exceeds the taxpayer's taxable income attributable to earned net income computed without regard to such item of gross income.

(4) *Illustrations.* The provisions of this section may be illustrated by the following examples:

Example 1. (i) H and W, married calendar-year taxpayers filing a joint return, have the following items of income, deductions, and tax preference for 1976:

(a) Salary	$155,000	
(b) Dividends and interest	60,000	
Total	215,000	
(c) Deductible travel expenses of employee allocable to earned income	5,000	
(d) Adjusted gross income		$210,000
(e) Exemptions and itemized deductions		38,000
(f) Taxable income		172,000

In addition, the taxpayers have tax preference items for 1976 of $80,000 attributable to the exercise of a qualified stock option and total tax preference items of $300,000 for the years 1972 through 1975. Since the items of tax preference for 1976 exceed the average of the items of tax preference for the years 1972 through 1976, the tax preference offset for 1976 is $50,000 ($80,000 − $30,000).

(ii) H and W have earned taxable income of $72,857 determined in the following manner:

(a) Earned income		$155,000
(b) Earned net income ($155,000 − $5,000)		150,000
(c) Taxable income		172,000
(d) Adjusted gross income		210,000
(e) Taxable income attributable to earned net income: $172,000(c) × ($150,000(b) / $210,000(d)	$122,857	
(f) Tax preference offset	50,000	
(g) Earned taxable income		72,857

(iii) The tax imposed by section 1 is $90,938, determined pursuant to section 1348 in the following manner:

(a) Applicable amount from col. (2) of table A, § 1.1348–2(a)		$18,060
(b) 50 pct of amount by which $72,857 (earned taxable income) exceeds $52,000 (applicable amount from col. (1) of table A, § 1.1348–2(a))		10,429
(c) Tax computed under section 1 on $172,000 (taxable income)	$91,740	
(d) Tax computed under section 1 on $72,857 (earned taxable income)	29,291	
(e) Item (c) minus item (d)		962,449
(f) Tax (total of items (a), (b), and (e))		90,938

Example 2. (i) H and W, married calendar-year taxpayers filing a joint return, have the following items of income, deductions, and tax preference for 1976:

(a) Salary	$210,000	
(b) Dividends and interest	20,000	
(c) Net long-term capital gains	100,000	
Total	330,000	
(d) Sec. 1202 deduction (½ of net long-term capital gains)	50,000	
(e) Adjusted gross income		$280,000
(f) Exemptions and itemized deductions		40,000
(g) Taxable income		240,000

The taxpayers' tax preference item for 1976 is one-half of the net long-term capital gains of $100,000, or $50,000. The taxpayers have no items of tax preference for the years 1972 through 1975. Accordingly, their tax preference offset for 1976 is $20,000 ($50,000 − $30,000).

(ii) H and W have earned taxable income of $160,000, determined in the following manner:

(a) Earned net income		$210,000
(b) Taxable income		240,000
(c) Adjusted gross income		280,000
(d) Taxable income attributable to earned net income: $240,000(b) × ($210,000(a) / $280,000(c))	180,000	
(e) Tax preference offset	$20,000	
(f) Earned taxable income		$160,000

(iii) The tax imposed by section 1 is $122,560, determined pursuant to section 1348 in the following manner:

(a) Applicable amount from col. (2) of table A, § 1.1348–2(a)			$18,060
(b) 50 pct of amount by which $160,000 (earned taxable income) exceeds $52,000 (applicable amount from col. (1) of table A, § 1.1348–2(a))			54,000
(c) Tax computed under section 1201(b) on $240,000 (taxable income):			
(1) Tax under section 1201(b)(1) (tax under section 1 on $190,000 (taxable income excluding capital gains))	$104,080		
(2) Tax under section 1201(b)(2) (25 pct of subsection (d) gain of $50,000)	12,500		
(3) Tax under section 1201(b)(3) (tax under section 1 on $240,000 (taxable income) less tax under section 1 on $215,000 (amount subject to tax under section 1201(b)(1) plus 50 pct of subsection (d) gain)) ($138,980 − $121,480)	17,500		
Total		134,080	
(d) Tax computed under section 1 on $160,000 (earned taxable income)		83,580	
(e) Item (c) through item (d)			50,500
(f) Tax (total of items (a), (b), and (e))			$122,560

Example 3. (i) A, an unmarried calendar year taxpayer engaged in the practice of law, has the following items of income and deductions for 1973 and 1976:

	1973	1976
Gross income from law practice	$240,000	$100,000
Dividends	60,000	20,000
Expense paid in law practice	50,000	160,000
Investment interest	30,000	10,000
Casualty loss on personal residence (amount in excess of $100)		50,000

(ii) For 1976, A's deductions exceed his gross income, and his taxable income is therefore zero. In addition, A has a net operating loss of $100,000 (i.e., the excess of his deductions of $220,000 over his gross income of $120,000), which may be carried back to 1973. In computing his taxable income and earned taxable income for 1973, $60,000 (i.e., the excess of the expenses paid in A's law practice of $160,000, over his gross income from his law practice of $100,000) of the net operating loss deduction is properly allocable to or chargeable against earned income.

(iii) A's recomputed taxable income and earned taxable income for 1973 are $119,250 and $103,350 respectively, determined in the following manner:

Gross income ($240,000 + $60,000)	$300,000
Adjusted gross income ($300,000 − $50,000 − $100,000)	150,000
Taxable income ($150,000 − $30,000 − $750)	119,250
Earned net income ($240,000 − $50,000 − $60,000)	130,000
Earned taxable income ($130,000 / $150,000 × $119,250)	$103,350

Example 4. The facts are the same as in example (3) except that A's gross income from his law practice for 1973 is $40,000. Thus, for 1973, A's deductions (including the net operating loss deduction) exceed his gross income, and his recomputed taxable income is therefore zero. The taxable income subtracted from the net operating loss to determine the carryback to 1974 is $20,000 (i.e., $40,000 + $60,000 − $50,000 − $30,000), and thus the net operating loss carryback to 1974 is $20,000 (i.e., $40,000 + $60,000 − $50,000 − $30,000), and thus the net operating loss carryback from 1976 to 1974 is $80,000 (i.e., $100,000 − $20,000). Of this amount, $48,000 ($80,000 × [$60,000 (the excess of the expenses paid in 1976 in A's law practice over his gross income from his law practice) ÷ $100,000 (A's net operating loss for 1976)]) is properly allocable to or chargeable against earned income, and must be taken into account in recomputing A's taxable income and earned taxable income for 1974.

Example 5. A, an unmarried calendar year taxpayer, receives a salary of $80,000 from Corporation X in 1975 and also owns and operates a laundry in which both his capital and services are material income producing factors. A incurs no section 62 expenses with respect to the salary income. In 1975 the laundry, a sole proprietorship, has gross income of $100,000 and business expenses deductible under section 62 of $80,000. A reasonable allowance as compensation for A's personal services rendered by him in his laundry business would be $12,000. The net profits of the laundry business were $20,000.

A's earned income from the laundry business is limited to $6,000 (30 percent of $20,000). A's total earned income is $36,000 ($80,000+$60,000). Since the section 62 deductions of the laundry business have already been taken into account in computing net profits, they are not again taken into account in computing earned net income. Accordingly, A's earned net income for 1975 is $86,000.

Example 6. The facts are the same as example (5) except that the gross income of the laundry is $130,000 and the net profits from the laundry are $50,000. A's earned income from the laundry is $12,000. Even though the 30-percent-of-net profits limitation has not resulted in a reduction of A's earned income from the laundry, the expenses deducted in computing net profits do not reduce earned income. Accordingly, both the earned income and the earned net income of A for 1975 are $92,000.

Example 7. The facts are the same as example (5) except that the gross income of the laundry is $60,000 and the laundry has a net loss of $20,000. A's earned income from the laundry is $12,000. Since the laundry does not have net profits, the expenses of the laundry have not been taken into account in computing the net profits limitation. Accordingly, a ratable portion of deductible expenses of the laundry must be allocated to the earned income from the laundry in accordance with §1.1348–2(d)(2); $16,000 of the expenses are allocated to the earned income ($12,000/$60,000×$80,000). A's total earned income for 1975 is $92,000, and his earned net income is $76,000 ($92,000 minus $16,000).

[T.D. 7446, 41 FR 55337, Dec. 20, 1976, as amended by T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.1348–3 Definitions.

(a) *Earned income*—(1) *In general.* (i) For purposes of section 1348 and the regulations thereunder, the term *earned income* means any item of gross income which is earned income within the meaning of section 401(c)(2)(C) or 911(b) unless the item constitutes deferred compensation as defined in paragraph (b) of this section or is otherwise excluded by application of this paragraph. Thus, subject to such exceptions, the term includes:

(A) Wages, salaries, professional fees, bonuses, amounts includible in gross income under section 83, commissions on sales or on insurance premiums, tips, and other amounts received, actually or constructively, as compensation for personal services actually rendered regardless of the medium or basis of payment.

(B) Compensatory payments for personal services made prior to the time such services are actually rendered, provided such advance payments are not made for a purpose of minimizing Federal income taxes by reason of the application of section 1348, and are either customary in the particular profession, trade, or business, or are made for a bona fide business purpose.

(C) Prizes and awards in recognition of personal services includible in gross income under section 74, amounts includible in gross income under section 79 (relating to group-term life insurance purchased for employees), and amounts includible in gross income under section 1379(b) (relating to contributions to qualified pension plans in the case of certain shareholder-employees); and

(D) Gains (other than gain which is treated as capital gain under any provision of chapter 1) and net earnings derived from the sale or other disposition of, the transfer of any interest in,