

such election, it must apply for permission from the Commissioner. Such application shall be made in accordance with the provisions of section 446(e).

[T.D. 6937, 32 FR 16395, Nov. 30, 1967; 32 FR 17479, Dec. 6, 1967]

§ 1.456-7 Transitional rule.

(a) Under section 456(d)(1), a taxpayer making an election under section 456 shall include in its gross income for the first taxable year to which the election applies and for each of the 2 succeeding taxable years not only that portion of prepaid dues income which is includible in gross income for each such taxable year under section 456(a), but also an additional amount equal to that portion of the total prepaid dues income received in each of the 3 taxable years preceding the first taxable year to which the election applies which would have been includible in gross income for such first taxable year and such 2 succeeding taxable years had the election under section 456 been effective during such 3 preceding taxable years. In computing such additional amounts—

(1) In the case of taxpayers who did not include in gross income for the taxable year preceding the first taxable year for which the election is effective, that portion of the prepaid dues income received in such year attributable to a liability which is to end within 12 months after the date of receipt, no effect shall be given to a “within 12 months” election made under paragraph (c) of §1.456-6, and

(2) There shall be taken into account only prepaid dues income arising from a trade or business with respect to which an election is made under section 456 and § 1.456-6.

Section 481 and the regulations thereunder shall have no application to the additional amounts includible in gross income under section 456(d) and this section, but section 481 and the regulations thereunder shall apply to prevent other amounts from being duplicated or omitted.

(b) A taxpayer who makes an election with respect to prepaid dues income, and who includes in gross income for any taxable year to which the election applies an additional amount computed under section 456(d)(1) and paragraph (a) of this section, shall be permitted under section 456(d)(2) to deduct for such taxable year and for each of the 4 succeeding taxable years an amount equal to one-fifth of such additional amount, but only to the extent that such additional amount was also included in the taxpayer’s gross income for any of the 3 taxable years preceding the first taxable year to which such election applies. The taxpayer shall maintain books and records in sufficient detail to enable the district director to determine upon audit that the additional amounts were included in the taxpayer’s gross income for any of the 3 taxable years preceding such first taxable year. If, however, the taxpayer ceases to exist, as described in paragraph (b) of §1.456-4, and there is included in gross income, under such paragraph, of the year of cessation the entire portion of prepaid dues income not previously includible in gross income under section 456 for preceding taxable years (other than for amounts received prior to the first year for which an election was made), all the amounts not previously deducted under this paragraph shall be permitted as a deduction in the year of cessation of existence.

(c) The provisions of this section may be illustrated by the following example:

Example. (1) Assume that X Corporation, a membership organization qualified to make the election under section 456, elects to report its prepaid dues income in accordance with the provisions of section 456 for its taxable year ending December 31, 1961. Assume further that X Corporation receives in the middle of each taxable year \$3,000 of prepaid dues income in connection with a liability to render services over a 3-year period beginning with the date of receipt. Under section 456(a), X Corporation will report income received in 1961 and subsequent years as follows:

Year of receipt	Total receipts	1961	1962	1963	1964	1965	1966	1967	1968
1961	\$3,000	\$500	\$1,000	\$1,000	\$500
1962	3,000	500	1,000	1,000	\$500

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Year of receipt	Total receipts	1961	1962	1963	1964	1965	1966	1967	1968
1963	3,000	500	1,000	1,000	\$500
1964	3,000	.....	.....	.....	500	1,000	1,000	\$500	.....
1965	3,000	.....	.....	.....	.....	500	1,000	1,000	\$500
1966	3,000	.....	.....	.....	.....	.....	500	1,000	1,000
1967	3,000	.....	.....	.....	.....	.....	.....	500	1,000
1968	3,000	.....	.....	.....	.....	.....	.....	.....	500
Total reportable under section 456(a)		500	1,500	2,500	3,000	3,000	3,000	3,000	3,000

(2) Under section 456(d) (1), X Corporation must include in its gross income for the first taxable year to which the election applies and for each of the 2 succeeding taxable years, the amounts which would have been

included in those years had the election been effective 3 years earlier. If the election had been effective in 1958, the following amounts received in 1958, 1959, and 1960 would have been reported in 1961 and subsequent years:

Year of receipt	Amount received	Years of including additional amounts		
		1961	1962	1963
1958	\$3,000	\$500	.....	.....
1959	3,000	1,000	\$500	.....
1960	3,000	1,000	1,000	\$500
Total additional amounts to be included under section 456(d)(1)		2,500	1,500	500

(3) Having included the additional amounts as required by section 456(d)(1), and assuming such amounts were actually included in gross income in the 3 taxable years preceding the first taxable year for which the election

is effective, X Corporation is entitled to deduct under section 456(d)(2) in the year of inclusion and in each of the succeeding 4 years an amount equal to one-fifth of the amounts included, as follows:

Year of inclusion	Amount	Years of deduction							
		1961	1962	1963	1964	1965	1966	1967	
1961	\$2,500	\$500	\$500	\$500	\$500	\$500	.....	.....
1962	1,500	.....	300	300	300	300	\$300	.....
1963	500	.....	.....	100	100	100	100	\$10
Total amount deductible under section 456(d)(2)		500	800	900	900	900	400	100	

(4) The net result of the inclusions under section 456(d)(1) and the deductions under

section 456(d)(2) may be summarized as follows:

	1961	1962	1963	1964	1965	1966	1967	1968
Amount includible under section 456(a)	\$500	\$1,500	\$2,500	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000
Amount includible under section 456(d)(1)	2,500	1,500	500	.....	.....	.....	.....	.....
Total	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000
Amount deductible under section 456(d)(2)	500	800	900	900	900	400	100	.....
Net amount reportable under section 456	2,500	2,200	2,100	2,100	2,100	2,600	2,900	3,000

[T.D. 6937, 32 FR 16396, Nov. 30, 1967]

§ 1.457-1 Compensation deferred under eligible State deferred compensation plans.

ning after December 31, 1978, section 457(a) provides that amounts deferred (within the meaning of § 1.457-1(d)(3))

(a) Year of inclusion in gross income—
(1) In general. For taxable years begin-