

# Fishing Information Newsletter

*News You Can Use from the Internal Revenue Service*

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## Message from the Editor

This edition of the newsletter contains the final installment in a series of articles on health insurance and an article covering the tax reporting requirements for oil spill payments received.

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*Please send us your topic ideas and questions....*

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## Oil Spill Distributions

*By Sonia Oen, Senior Tax Specialist  
Anchorage, Alaska*

The Exxon Qualified Settlement Fund plans to distribute payments during 2002. Following is the Internal Revenue Service's position regarding the taxability of these payments. Recipients will receive a Form 1099-MISC or substitute for this form along with each payment received from the settlement fund. Therefore, at the end of the year you may have multiple payments and Forms 1099 to summarize for your tax reporting requirements.

**Direct Action Plaintiffs:** You are responsible for reporting the entire amount of settlement that you receive, regardless if any money has been withheld to pay attorney fees. This amount will be reported on the Form

1099-MISC you receive with your payment. You may then deduct the attorney fees as an expense on your tax return as follows:

- A self-employed person receiving payments for lost fishing profits or as a crewmember of a fishing boat will deduct the attorney fees as a business deduction on Schedule C.
- Individuals that are not self-employed and receiving payments for lost wages or subsistence claims will deduct the attorney fees as a miscellaneous itemized deduction on Schedule A.
- Corporations and partnerships will deduct the attorney fees as a business deduction on their appropriate tax returns.
- Attorney fees relating to devaluation of assets will be capitalized as a portion of the basis of that asset.

Depending on your situation you may have to allocate your attorney fees between different types of payments received. For example if you received payments for both lost fishing proceeds and devaluation of your fishing permit, then the fees paid to your attorney must be allocated between the two payments that you received.

**Class Action Plaintiffs:** You will receive a Form 1099-MISC that is net of any attorney fees withheld. You include only the net income on your tax return, and you may not deduct any attorney fees as an expense.

The following summary will assist you in determining how to report the income.

**PAYMENT FOR LOST PROFITS,** reported to you on Form 1099-MISC Box 7, as Non-employee Compensation. This income is reported as if you had earned it from fishing. The payment for lost profits qualify under Internal Revenue Code (IRC) Section 7518(a)(1)(A) as income earned from an agreement vessel for capital construction fund purposes.

- *Sole Proprietorships* - Form 1040 Schedule C –Line 1 - Gross Receipts
- *Partnerships* - Form 1065 – Line 1a - Gross Receipts
- *Corporations* – Forms 1120 and 1120S – Line 1a – Gross Receipts

**PAYMENT TO CREWMEMBERS OF FISHING BOATS**, reported to you on Form 1099–MISC Box 7, as Non-employee Compensation, if you were considered self-employed. This income is reported as if you had earned it from fishing. You will report it as gross receipts on Form 1040 Schedule C – Line 1 – Gross Receipts.

**PAYMENT TO CREWMEMBERS OF FISHING BOATS**, reported to you on Form 1099–MISC Box 3, as Other Income, if you were considered an employee. This income is reported as other income on Line 21 of your Form 1040. The settlement payments are not subject to FICA or self-employment taxes. The settlement for lost wages is not considered earned income for the purposes of the earned income credit, and does not represent passive or non-passive income for the purposes of passive activity losses under IRC Section 469.

**PAYMENT FOR LOST WAGES TO CANNERY WORKERS** reported to you on Form 1099–MISC Box 3, as Other Income. This income is reported as other income on Line 21 of your Form 1040. The settlement payments are not subject to FICA or self-employment taxes. The settlement for lost wages is not considered earned income for the purposes of the earned income credit, and they do not represent passive or non-passive income for the purposes of passive activity losses under IRC Section 469.

**PAYMENT FOR SUBSISTENCE CLAIMS** reported to you on Form 1099-MISC Box 3, as Other Income. This income is reported as other income on Line 21 of your Form 1040.

**PAYMENT FOR LOSS IN VALUE OF PROPERTY.** You will not receive a Form 1099-MISC. The portion of the settlement payments attributable to fishing permit, fishing vessel or other asset devaluation should be applied as a decrease to the capital investment (basis) in the property. If there is no basis in the property, or if the payments exceed the basis, the excess is capital gain income.

**PAYMENT FOR INTEREST INCOME.** You will only receive a Form 1099–INT if the amount you received in interest is over \$600, however, you must report as interest income all payments, including those under \$600.

## Health Insurance – Partnership & S Corporation

*By Jacki Morin, Revenue Agent  
Bangor, Maine*

Special considerations for the fisherman filing a Form 1065 – Partnership Return or a Form 1120S – S Corporation Return.

Premiums for health insurance coverage paid by a partnership on behalf of a partner, for services as a partner, are treated as guaranteed payments. As guaranteed payments, the premiums are deductible by the partnership and includible in the partner’s gross income. The partner may deduct the cost of the premiums on his personal return as an adjustment to income subject to the applicable limitations. The partnership must report the cost of health insurance premiums on Schedule K-1, Form 1065.

A partnership may account for health insurance premiums paid on behalf of a partner as a reduction in distributions to the partner. Under these circumstances, the premiums are not deductible by the partnership. The distributive shares of partnership income and deduction are not affected by the payment of the premiums. A partner may deduct the cost of the premiums on his personal return as an adjustment to income subject to the appropriate limitations.

Premiums for health insurance paid by an S corporation on behalf of a more than 2% shareholder, to the extent of W-2 wages received from the S corporation, are deductible on the corporate return, but the shareholder must include the amount of the premiums in income on the shareholder’s Form 1040. (Constructive rules of ownership apply.) The income should be included on the shareholder’s Form W-2 as taxable wages. Those wages, though, are not subject to FICA or FUTA as regular wages are. If the amount of the premium is not included on the shareholder’s Form W-2, it should be reported as Other Income on Line 21 of the shareholder’s Form 1040.

The amount of premiums paid by the S corporation on behalf of each shareholder should be reflected on each shareholder's Schedule K-1, Line 23, Supplemental Information. The reason for the K-1 reporting is two fold. First, if the amount of the premium is not included in the shareholder's Form W-2 there has to be a statement on the K-1, Line 23, showing the amount of the premiums to include as other income on the shareholder's Form 1040. Second, these premiums are deductible on the shareholder's individual return as an adjustment to income subject to the appropriate limitations. An S corporation shareholder is considered self-employed with regard to medical insurance premiums. Remember, if the shareholder does not work for the S corporation, the shareholder cannot have any earned income from the activity and therefore cannot deduct the insurance premiums on his personal return. Also, if the shareholder or the shareholder's spouse is qualified to participate in any subsidized health plan maintained by any employer of the taxpayer or the taxpayer's spouse, the shareholder is not allowed to deduct self-employed medical insurance as an adjustment to income. Any amount not allowed as an adjustment to income is allowable as an itemized deduction. (See Publication 535 for the Self-Employed Health Insurance Deduction Worksheet.)

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<http://www.irs.gov/businesses/small/display/0,,i1%3D2%26i2%3D23%26genericId%3D83569,00.html>

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## Taxpayer Assistance

### Phone Numbers:

(800) 829-1040

(800) 829-4059 TTY/TDD (Hearing Impaired)

Call with general tax questions. Hours of Operation 7:00 a.m. to 10:00 p.m. Monday through Friday and Saturdays 9 a.m. to 5 p.m. during the tax-filing season.

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