

Internal Revenue Service, Treasury

§ 1.57-4

1. Section 852(b)(1) tax computed as if it were applicable to all income including capital gains:		
Amount subject to section 852(b)(1)		\$125,000
Net section 1201 gain	\$800,000	
Less: Dividends paid deduction	700,000	
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Net section 1201 gain subject to tax at the company level		100,000
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		225,000
Normal tax (0.22×\$225,000)		\$49,500
Surtax (0.26×200,000)		52,000
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		101,500
2. Tax comparable to section 1201(a) tax section 852(b)(1) tax:		
Normal tax (0.22×125,000)	\$27,500	
Surtax (0.26×100,000)	26,000	\$53,500
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Section 852(b)(3) tax (0.30×100,000)		30,000
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		\$83,500
3. Excess		
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		18,000
4. Normal tax rate plus surtax rate		
		.48
5. Capital gains preference (line 3 divided by line 4)		
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		37,500

(iv) For the computation of the capital gains item of tax preference in the case of an electing small business corporation (as defined in section 1371(b)), see § 1.58-4(c).

(3) *Nonresident aliens, foreign corporations.* In the case of a nonresident alien individual or foreign corporation, there shall be included in computing the capital gains item of tax preference under section 57(a)(9) only those capital gains and losses included in the computation of income effectively connected with the conduct of a trade or business within the United States as provided in section 871(b) or 882.

[T.D. 7564, 43 FR 40470, Sept. 12, 1978]

§§ 1.57-2—1.57-3 [Reserved]

§ 1.57-4 Limitation on amounts treated as items of tax preference for taxable years beginning before January 1, 1976.

(a) *In general.* If in any taxable year beginning before January 1, 1976, a taxpayer has deductions in excess of gross income and all or a part of any item of tax preference described in § 1.57-1 results in no tax benefit due to modifications required under section 172(c) or section 172(b)(2) in computing the amount of the net operating loss or the net operating loss to be carried to a succeeding taxable year, then, for purposes of section 56(a)(1), the sum of the

items of tax preference determined under section 57(a) (and § 1.57-1) is to be limited as provided in paragraph (b) of this section.

(b) *Limitation.* The sum of the items of tax preference, for purposes of section 56(a)(1) and § 1.56A-1(a), is limited to an amount determined under subparagraphs (1) and (2) of this paragraph.

(1) *Loss year.* If the taxpayer has no taxable income for the taxable year without regard to the net operating loss deduction, the amount of the limitation is equal to—

(i) In cases where the taxpayer does not have a net operating loss for the taxable year, the amount of the recomputed income (as defined in paragraph (c) of this section) or

(ii) In cases where the taxpayer has a net operating loss for the taxable year, the amount of the net operating loss (expressed as a positive amount) increased by the recomputed income or decreased by the recomputed loss for the taxable year (as defined in paragraph (c) of this section,

plus the amount of the taxpayer's stock option item of tax preference (as described in § 1.57-1(f)).

(2) *Loss carryover and carryback years.* Except in cases to which subparagraph (1)(ii) of this paragraph applies, if, in

any taxable year to which a net operating loss is carried, a capital gains deduction is disallowed under section 172(b)(2) in computing the amount of such net operating loss which may be carried to succeeding taxable years, the amount of the limitation is equal to the amount, if any, by which the sum of the items of tax preference (computed with regard to subparagraph (1)(i) of this paragraph) exceeds the lesser of—

(i) The amount by which such loss is reduced because of a disallowance of the capital gains deduction in such taxable year, or

(ii) The capital gains deduction.

The amount determined pursuant to the preceding sentence shall be increased by the amount, if any, that such reduction is attributable to that portion of such a net operating loss described in section 56(b)(1)(B) and § 1.56A-2(a)(2) (relating to excess tax preferences).

(c) *Recomputed income or loss.* For purposes of this section, the phrase “recomputed income or loss” means the taxable income or net operating loss for the taxable year computed without regard to the amounts described in § 1.57-1 except paragraph (i)(2) of that section (relating to corporate capital gains) and without regard to the net operating loss deduction. For this purpose, the reference to the amounts described in § 1.57-1 is a reference to that portion of the deduction allowable in computing taxable income under the appropriate section equal to the amount which is determined in each paragraph of § 1.57-1. For example, the amount described in § 1.57-1(h) (relating to excess of percentage depletion over basis) is that portion of the deduction allowable for depletion under section 611 which is equal to the amount determined under § 1.57-1(h). For purposes of this paragraph, the amount described in § 1.57-1(i)(1) (relating to capital

gains) is to be considered as the amount of the deduction allowable for the taxable year under section 1202.

(d) *Determination of preferences reduced.* When, pursuant to paragraph (b)(1) of this section, the sum of the items of tax preference (determined without regard to this section) are reduced, such reduction is first considered to be from the capital gains item of tax preference (described in § 1.57-1(i)(1)) and each item of tax preference relating to a deduction disallowed in computing the net operating loss pursuant to section 172(d), pro rata. The balance of the reduction, if any, is considered to be from the remaining items of tax preference, pro rata. For purposes of this subparagraph, deductions not attributable to the taxpayer's trade or business which do not relate to items of tax preference are considered as being applied in reducing gross income not derived from such trade or business before such deductions which do relate to items of tax preferences.

(e) *Examples.* The principles of this section may be illustrated by the following examples in each of which the deduction for the personal exemption is disregarded and the taxpayer is an individual who is a calendar year taxpayer.

Example 1. The taxpayer has the following items of income and deduction for 1970:

Gross income (all business income)	\$120,000
Deductions:	
Nonbusiness deductions	30,000
Items of tax preference (excess accelerated depreciation on real property held in taxpayer's business)	80,000
Other business deductions	50,000

Based on the above figures, the taxpayer has a net operating loss of \$10,000 (business deductions of \$130,000 less business income of \$120,000, the nonbusiness deductions having been disallowed by reason of section 172(d)(4)). The limitation on the amount treated as items of tax preference is computed as follows:

Tax preferences	\$80,000
Net operating loss	\$10,000
Recomputed income or loss:	
Gross income	\$120,000
Deductions other than tax preference items	80,000
Recomputed income	40,000
Sum of net operating loss and recomputed income	50,000

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Stock options preference	0
Limitation	50,000

Thus, the minimum tax computed under section 56(a) would be 10 percent of \$20,000 (items of tax preference of \$50,000 less the minimum tax exemption of \$30,000), \$1,000 of which would be deferred tax liability pursuant to section 56(b).

Example 2. Assume the same facts as in example 1 except that the other business deductions are \$130,000, resulting in a net operating loss of \$90,000. The limitation on the amount treated as items of tax preference is computed as follows:

Tax preferences	\$80,000
Net operating loss	\$90,000
Recomputed income or loss:	
Gross income	\$120,000
Deductions other than tax preference items	160,000
	(40,000)
Disallowance of nonbusiness deductions under sec. 172(d)	30,000
Recomputed loss	10,000
Net operating loss less recomputed loss	80,000
Stock options preference	0
Limitation	80,000

Thus, the minimum tax computed under section 56(a) would be 10 percent of \$50,000 (items of tax preference of \$80,000 less the minimum tax exemption of \$30,000), all of

which will be deferred tax liability pursuant to section 56(b).

Example 3. The taxpayer has the following items of income and deduction for 1970:

Gross income (all from business):	
Ordinary	\$50,000
Net section 1201 gains	120,000
Deductions:	
Items of tax preference:	
Excess amortization of certified pollution control facilities	\$45,000
Capital gains deduction	60,000
Other business deductions	75,000

In addition, the taxpayer has a \$55,000 item of tax preference resulting from qualified stock options. Based on the above figures, the taxpayer has no taxable income and no net operating loss as the capital gains deduc-

tion is disallowed in determining the net operating loss pursuant to section 172(d). The limitation on the amount treated as items of tax preference is computed as follows:

Tax preferences	\$160,000
Net operating loss	0
Recomputed income or loss:	
Gross income	\$170,000
Deductions other than tax preference items	75,000
Recomputed income	\$95,000
Plus: Stock options preference	55,000
Limitation	150,000

Thus, the minimum tax computed under section 56 would be 10 percent of \$120,000 (items of tax preference of \$150,000 less the minimum tax exemption of \$30,000).

Example 4. Assume the same facts as in example (3) except that the taxpayer has a net

operating loss carryover from 1969 of \$80,000. The taxpayer has \$160,000 of tax preferences which are limited to \$150,000 pursuant to § 1.57-4(b)(1). In order to determine the amount of the 1969 net operating loss which

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remains as a carryover to 1971, the 1970 taxable income is redetermined in accordance with section 172(b)(2) and the regulations thereunder, as follows:

Gross income—1970	\$170,000	
Deductions:		
Capital gains deduction dis-		
allowed business deduc-		
tions	\$120,000	120,000
Taxable income for section 172(b)(2) ...		50,000

Thus, the 1969 net operating loss which remains as a carryover to 1971 is \$30,000. Pursuant to paragraph (b)(2) of this section, the limitation on the amount treated as items of tax preference is computed as follows:

Items of tax preference computed with regard to § 1.57-4(b)(1) (per example (3))	\$150,000
Less: Lesser of capital gains deduction (\$60,000) or amount of reduction in carryover due to its disallowance (\$50,000)	50,000
Limitation	100,000

Thus, the minimum tax computed under section 56 would be 10 percent of \$70,000 (items of tax preference of \$100,000 less the minimum tax exemption of \$30,000).

Example 5. The taxpayer has the following items of income and deduction for the taxable year 1970 without regard to any net operating loss deduction:

Gross income (all from business):		
Ordinary	\$50,000	
Net section 1201 gain	40,000	
		\$90,000
Deductions:		
Capital gains deduction	20,000	
Medical expenses (\$4,100 actually paid but allowable only to the extent in excess of 3 percent of adjusted gross income of \$70,000)	2,000	
Other itemized deductions	40,000	
		62,000
Taxable income (before net operating loss deduction)		28,000

In addition, the taxpayer has an item of tax preference of \$35,000 resulting from qualified stock options. In 1973, the taxpayer has a net operating loss of \$60,000 (no portion of which is attributable to excess tax preferences pursuant to § 1.56A-2) which is carried back to 1970 resulting in no taxable income in 1970. In order to determine the amount of the 1973 net operating loss which remains as a carryover to 1971, the 1970 taxable income is redetermined, in accordance with section 172(b)(2) and the regulations thereunder, as follows:

Gross income	\$90,000
Deductions:	
Capital gains deduction dis-	
allowed	

Medical expenses (\$4,100 actually paid but allowable only to the extent in excess of 3 percent of adjusted gross income of \$90,000)	\$1,400
Other itemized deductions	40,000
	\$41,400
Taxable income for section 172(b)(2)	48,600

The limitation on the amount treated as items of tax preference is computed as follows:

Items of tax preference:	
Capital gains	\$20,000
Stock options	35,000
	55,000
Less:	
Lesser of capital gains deduction (\$20,000) or amount of reduction in carryover due to its disallowance (\$20,600)	(20,000)
Limitation	35,000

Thus, the minimum tax for 1970 under section 56 would be 10 percent of \$5,000 (items of tax preference of \$35,000 less the minimum tax exemption of \$30,000).

Example 6. Assume the same facts as in example (5) except that the 1973 net operating loss was \$45,000. In this case, the \$20,600 increase in the 1970 taxable income as redetermined, results in a decrease of \$17,000 (i.e., the remaining 1973 net operating loss after an initial decrease of \$28,000 resulting from the 1970 taxable income before redetermination). The limitation on the amount treated as items of tax preference is computed as follows:

Items of tax preference computed without regard to this section	\$55,000
Less: Lesser of capital gains deduction (\$20,000) or amount of reduction in carryover due to its disallowance (\$17,000)	(17,000)
Limitation	38,000

Thus, the minimum tax for 1970 under section 56 would be 10 percent of \$8,000 (items of tax preference of \$38,000 less the minimum tax exemption of \$30,000).

Example 7. The taxpayer has the following items of income and deduction for 1973 without regard to any net operating loss deduction:

Gross income (all from business):		
Ordinary	\$100,000	
Net section 1201 gains	120,000	
		\$220,000
Deductions:		
Items of tax preference:		
Excess amortization of certified pollution control facilities	45,000	
Capital gains deduction	60,000	
	105,000	
Other business deductions	75,000	

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	\$180,000
Taxable income (before net operating loss deduction)	40,000

In 1972, the taxpayer had a net operating loss of \$70,000 which is carried forward to 1973; \$20,000 of this net operating loss is attributable to excess tax preferences. In order to determine the amount of the 1972 net operating loss which remains as a carryover to 1974, the 1973 taxable income is redetermined, in accordance with section 172(b)(2) and the regulations thereunder, as follows:

Gross income	\$220,000
Deductions:	
Capital gains deduction	Disallowed
Business deductions	120,000
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Taxable income per section 172(b)(2) ..	100,000

In this case, the \$60,000 increase in the 1972 taxable income as redetermined and the \$30,000 decrease in the amount of the 1973 net operating loss remaining as a carryover to 1974 (i.e., the remaining 1972 net operating loss after an initial decrease of \$40,000 resulting from the 1973 taxable income before redetermination) is entirely attributable to the disallowance of the capital gains deduction. The limitation on the amount treated as items of tax preference is computed as follows:

Items of tax preference computed without regard to this section:	
Capital gains	\$60,000
Excess amortization of certified pollution control facilities	45,000
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	105,000
Less: Lesser of capital gains deduction (60,000) or amount of reduction in carryover due to its disallowance (\$30,000)	(30,000)
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	75,000
Plus: Amount of reduction of carryover (due to disallowance of capital gains deduction) attributable to excess tax preferences	20,000
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Limitation	95,000

[T.D. 7564, 43 FR 40476, Sept. 12, 1978, as amended by T.D. 8138, 52 FR 15309, Apr. 28, 1987]

§ 1.57-5 Records to be kept.

(a) *In general.* The taxpayer shall have available permanent records of all the facts necessary to determine with reasonable accuracy the amounts described in §1.57-1. Such records shall include:

(1) In the case of amounts described in paragraph (a) of §1.57-1: the amount and nature of indebtedness outstanding for the taxable year and the date or dates on which each such indebtedness was incurred or renewed in any form; the amount expended for property held

for investment during any taxable year during which such indebtedness was incurred or renewed; and the manner in which it was determined that property was or was not held for investment.

(2) In the case of amounts described in paragraphs (b), (c), (d), (e), and (h) of §1.57-1:

(i) The dates, and manner in which, the property was acquired and placed in service,

(ii) The taxpayer's basis on the date the property was acquired and the manner in which the basis was determined,

(iii) An estimate of the useful life (in terms of months, hours of use, etc., whichever is appropriate) of the property on the date placed in service or an estimate of the number of units to be produced by the property on the date the property is placed in service, whichever is appropriate, and the manner in which such estimate was determined,

(iv) The amount and date of all adjustments by the taxpayer to the basis of the property and an explanation of the nature of such adjustments, and

(v) In the case of property which has an adjusted basis reflecting adjustments taken by another taxpayer with respect to the property or taken by the taxpayer with respect to other property, the information described in paragraph (a)(2)(i) through (iv) of this section, with respect to such other property or other taxpayer.

(3) In the case of amounts described in paragraph (f) of §1.57-1, the fair market value of the shares of stock at the date of exercise of the option and the option price and the manner in which each was determined.

(4) In the case of amounts described in paragraph (g) of §1.57-1, the amount of debts written off and the amount of the loans outstanding for the taxable year and the 5 preceding taxable years or such shorter or longer period as is appropriate.

(b) *Net operating losses.* The taxpayer shall have available permanent records for the first taxable year in which a portion of a net operating loss was attributable to items of tax preference (within the meaning of §1.56A-2 (b)) and each succeeding taxable year in which there is a net operating loss or a