Fishing Information Newsletter

News You Can Use from the Internal Revenue Service

New England District

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Message from the Coordinator

Welcome to the 21st century!

The beginning of a New Year marks the time we all should begin to organize our records in anticipation of timely filing tax returns. It's also an excellent time to make a resolution to better arrange your income and expense records so that the annual task is made much easier.

If you, or your organization, would like to sponsor a recordkeeping workshop, the IRS will provide a free instructor. Let our tax experts help you get organized for the coming century. Just contact me at the number shown below.

Speaking of planning ahead, we've mapped out the next several issues of the FIN and will cover some helpful tips on the proper filing of tax returns and information documents. But we always leave room for questions from the readership, so please drop us an e-mail with your topics!

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CONTINUED FROM THE DECEMBER '99 ISSUE

Capital Construction Fund (CCF)

Tax Treatment of CCF Earnings

Capital Gains

Do not report on your income tax return any capital gains from the sale of capital assets held in your CCF account. This includes capital gains distributions reported on Form 1099–DIV, *Dividends and Distributions*, or a substitute statement. However, you should attach a statement to your tax return listing the payers and the amounts. Identify the capital gains as "CCF account earnings."

Interest and Dividends

Do not report any ordinary income (such as interest and dividends) you earn on the assets in your CCF account. Nevertheless, you should attach a statement to your return to list the payers, the amounts and to identify them as "CCF account earnings." If you are required to file Form 1040, Schedule B, *Itemized Deductions & Interest and Dividend Income*, you can add these earnings to the list of payers and amounts on line 1, and identify them as "CCF earnings." Then subtract the same amounts from the list and identify them as "CCF deposits."

Tax-Exempt Interest

Do not report tax-exempt interest from state or local bonds you held in your CCF account on your federal tax return. *You are not required to report this interest on Form 1040, line 8b.*

Treatment of Qualified CCF Withdrawals

A qualified withdrawal from a CCF account is one that is approved by NMFS for *either* acquiring, building, or rebuilding qualified fishing vessels, *or* making principal payments on the mortgage of a qualified fishing vessel.

How to Determine the Source

When you make a qualified withdrawal, the amount you withdraw is treated as being made in the following order from your accounts — 1) capital account, 2) capital gain account, then 3) the ordinary income account.

Excluding Qualified Withdrawals from Tax

You do not need to report a qualified withdrawal from your CCF account on your income tax return.

Reducing Tax Basis

You must reduce the depreciable basis of fishing vessels you acquire, build, or rebuild for the costs paid for with funds withdrawn from the CCF (either the capital gain account or the ordinary income account).

Treatment of Nonqualified Withdrawals

A nonqualified withdrawal from a CCF account is any withdrawal that is not a qualified withdrawal.

Examples of nonqualified withdrawals include the following amounts from the ordinary income account or the capital gain account:

- Amounts remaining in a CCF account upon termination of your agreement with NOAA.
- Amounts you withdraw and use to make principal payments on the mortgage of a vessel with a basis that has already been reduced to zero.
- Amounts determined by IRS to cause your CCF account balance to exceed the amount that is appropriate to meet your planned use of withdrawals. (You will generally be given 3 years to revise your plans to cover this excess balance).
- Amounts you leave in your account for more than 25 years. (There are percentages beginning with year 26 and later that determine the amount of the non-qualified withdrawal).

How to Determine the Source

When you make a non-qualified withdrawal from your CCF account, the amount you withdraw is treated as being made from your accounts in the following order — 1) ordinary income account, 2) capital gain account, then 3) the capital account.

Paying Tax on Nonqualified Withdrawals

Nonqualified withdrawals, treated as made from either the ordinary income account or capital gain account, are taxed separately at the highest marginal ordinary income or capital gain tax rate from your other gross income.

For Partnerships and S corporations, taxable nonqualified partnership withdrawals are separately stated on Schedule K (Form 1065), line 24, and allocated to the partners on Schedule K–1 (Form 1065), line 25. Taxable nonquali-fied withdrawals by an S corporation are separately stated on Schedule K (Form 1120S), line 21, and allocated to the shareholders on Schedule K–1 (Form 1120S), line 23.

Interest

Interest must be paid on additional tax due to a non-qualified withdrawal. The interest period begins on the last date for paying tax for the tax year for which you deposited the amount you withdrew from your CCF account. The period ends on the last date for paying tax for the tax year in which you make the nonqualified withdrawal.

The interest rate on the nonqualified withdrawal is simple interest and subject to change annually. The rate is pub-lished in the Federal Register or by calling NOAA at (301) 713-2393.

Reporting Additional Tax and Interest

Attach a statement to your income tax return to show computation of both tax and interest on a nonqualified withdrawal. Include tax and interest on the nonqualified withdrawal on Form 1040, line 56 and write (to the left of line 56) the amount of tax, interest and "CCF."

Tax Benefit Rule

If any portion of your non-qualified withdrawal is properly attributable to contributions (not earnings on the contributions) you made to the fund that did not re-duce your tax liability for any tax year prior to the withdrawal year; the following tax treatment applies:

1. The portion that did not reduce your tax liability for any year prior to the withdrawal year is not taxed.

2. An amount equal to that portion is allowed as a net operating loss deduction.

Interest Deduction

You can deduct the interest you pay on a nonqualified withdrawal as a trade or business expense.

Additional Information Sources

Publication 595, *Tax Guide for Commercial Fishermen*, highlights some special tax rules for those who have their own fishing trade or business. It's available for free on the IRS Web site at www.irs.gov, or by calling the IRS Publications & Forms order line at (800)-829-3676.

Taxpayer Advocate Reminder

Need help with a long-standing tax issue that just doesn't seem to get resolved? Call the toll-free Taxpayer Advocate Hotline at 877-777-4778 for specialized assistance 7 days a week, 24 hours a day.

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