

Fishing Information Newsletter

News You Can Use from the Internal Revenue Service

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Message from the Editor

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 income and expense records so that the annual task is made much easier. To assist you in keeping better records keep in mind and review again last month's newsletter for the article on Recordkeeping Guidelines.

This edition of the newsletter contains dates and tips for filing your 2001 tax return.

As said by prior editors and I will say again if there is a topic that you would like addressed or if you have a fishing-related question you would like answered, please send us your topic ideas and questions to me at the addresses below. We will make every effort to see that they are addressed in future issues.

The Alaska Commercial Fishing Audit Technique Guide is currently being updated to include commercial fishing on a national level. The guide will now include the gulf, east, and west coasts. If you have any suggestions or topics you would like included please contact me by e-mail or regular mail.

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

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Important Dates to Remember:

January 31, 2002 –

By this date **Fishing boat operators** must have given a 2001 Form 1099-MISC, *Miscellaneous Income*, to certain crew members who were self-employed.

Form 1099 MISC, *Miscellaneous Income*, is required to be filed with the IRS for each person to whom you paid \$600 or more in cash for the purchase of fish. The total amount paid to the person is reflected in item 7, "Non-employee Compensation". Go to the April/May 2001 issue of the Fishing Information Newsletter for more information on cash payments to purchase certain fish.

Form 1099 –MISC is also required for each person to whom you have paid at least \$600 in rents, services, and other income payments to an individual who is not your employee (self-employed).

February 28, 2002 – By this date **Fishing boat operators** must send Copy A of Forms 1099-MISC to the IRS using Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*.

March 1, 2002 – For **Fishermen**, if at least two-thirds of your gross income for either 2000 or 2001 was from fishing, you can file your 2001 Form 1040 by this date and pay your tax in full without penalty (estimated tax penalty). When you file your return, remember to attach Form 2210-F, *Underpayment of Estimated Tax by Farmers and Fishermen*.

If you file your 2001 return and pay your entire tax liability prior to March 1, 2002, but still receive an estimated tax penalty notice from the Service Center, it is important that you immediately write to the address on the notice and explain why you think the notice was in error. Do not ignore a penalty notice even if you think it was sent to you by mistake.

If you received an estimated tax penalty notice in the past and paid the penalty without questioning it, but now feel you did not owe any penalty, you can file Form 843 requesting the penalty amount be refunded to you.

For further information on the estimated tax penalty go to the August 2001 edition of the FIN. In this issue we discussed the criteria for computing the estimated tax penalty for farmers and fishers and explained what you should do if you were assessed a penalty that you feel is incorrect.

Tax Tips and Reminders:

Fuel Tax Credit

A credit or refund may be allowed for the excise tax on fuel used in a boat engaged in commercial fishing. Boats engaged in commercial fishing include only watercraft used in taking, catching, processing, or transporting fish, shellfish, or other aquatic life for commercial purposes, such as selling or processing the catch, on a specific trip basis. They include boats used in both fresh and salt-water fishing. They do not include boats used for both sport fishing and commercial fishing on the same trip. See Publication 378 for more information.

Reminder - The amount of a fuel tax credit you received on your 2000 tax return must be reported as income on your 2001 return (*Cash Method*).

Fishing Patronage Dividends

Remember to report all "fishing patronage dividends" reported to you on Form 1099-PATR, *Taxable Distribution Received from Cooperatives*, as gross receipts on your business schedule. These dividends are subject to self-employment tax.

Car and Truck Expenses

If you use your car or truck in your business, you may be able to deduct the costs of operating and maintaining your vehicle. You can choose to deduct the actual business expenses of operating an automobile or you may be able to use the standard mileage rate. For 2001, the standard mileage rate is 34.5 cents a mile for all business miles. Beginning January 1, 2002, the standard mileage rate is 36.5 cents per mile.

Capital Construction Fund (CCF)

You can use a CCF account to defer income tax by making deposits to the CCF depositories. Deposits must be made by the due date of the tax return (plus any extensions).

You must report annual deposit and withdrawal activity to the National Marine Fisheries Service.

Deductions

Individuals

To take the deduction, subtract the CCF deposit from the amount that would normally be entered on line 39 of Form 1040, *U.S. Individual Income Tax Return*. In the margin to the left of line 39, write "CCF" and the total amount of these deposits. Do not deduct these CCF deposits on Form 1040, Schedule C, *Profit or Loss from Business (Sole Proprietorship)*, or C-EZ, *Profit or Loss from Business (Short Version)*.

If you deposit earnings from operations into your CCF account and you must complete other forms such as Form 6251, *Alternative Minimum Tax - Individuals*, or Schedule D worksheets, *Capital Gains and Losses*, you will need to make an extra computation. When the other form instructs you to use an amount from line 37 on Form 1040, do not use that amount. Instead, add lines 38 and 39 from Form 1040, and use that amount.

Self-Employment Tax

You must use your net profit or loss from your fishing business to figure your self-employment tax. When you compute your self-employment tax do not reduce your net profit or loss by any earnings from operations you deposited into your CCF account.

Partnerships and S Corporations

The CCF deduction for partnership earnings from operations that is deposited into a qualified CCF account is separately stated on line 11, Form 1065, Schedule K, *U.S. Partnership Return Income*, and allocated to the partners on line 11 of Form 1065, Schedule K-1, *Partner's Shares of Income, Credits, Deductions, Etc.*

The CCF deduction for S corporation earnings that are deposited into a qualified CCF account is separately stated on line 10 of Form 1120S, Schedule K, and allocated to the shareholders on Form 1120 S, Schedule K-1, *Shareholder's Share of Income, Credits, Deduction, etc.*, line 10.

Interest Deduction

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

Income

This section explains the tax treatment of the investment earnings from the assets in a CCF account when the earnings are redeposited or left in the CCF account. However, if you choose to withdraw the CCF investment earnings in the year earned, you must generally pay income tax.

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 and list the payers, the related amounts, and identify them as “CCF account earnings.” If you are required to file Form 1040, Schedule B 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.

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.

Reducing Tax Basis

You must reduce the depreciable basis of a qualified fishing vessel by the amount of qualified CCF funds

withdrawn and used to acquire, build, or rebuild that fishing vessel.

Treatment of Nonqualified Withdrawals

A nonqualified withdrawal from a CCF account is any withdrawal that is not used for acquiring, building, rebuilding a qualified fishing vessel, or making principal payments on the mortgage of a qualified fishing vessel.

Reporting Additional Tax and Interest on Nonqualified Withdrawals

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.”

Publication 595 has more information on CCF accounts and the topic has been covered in the December 1999, August/September 2000, November/December 2000, and January 2001 newsletters.

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.

Your Questions Answered

Will I be penalized with a 20% capital gains tax if I sell my fishing boat and licenses?

If there is a 20% tax when I sell my business, is it on the gross or the profit?

Is there a 1 year grace period to reinvest the money into another business?

If you sell your fishing boat and fishing license that results in a profit/gain, the **gain** is taxed. For example, assume the following facts:

Boat purchased for \$50,000

Depreciation claimed on returns (or allowable depreciation if higher) \$34,380

Remaining basis \$15,620 (\$50,000 cost minus \$34,380 depreciation = \$15,620 remaining basis)

Example 1: If you sell the boat for \$40,000, you will have a gain of \$24,380 (\$40,000 selling price minus \$15,620 basis = \$24,380). This gain is taxed at the ordinary income rates because it is less than the amount of the prior depreciation claimed. The rate of tax that you must pay on this \$24,380 will depend upon your other income and the tax bracket at which this income is taxed. The tax rate will not be the 20% long-term capital gains rate. Since depreciation recapture is treated as ordinary income, it is not eligible for the more beneficial capital gain treatment.

Example 2: If you sell the boat for \$60,000, you will have a gain of \$44,380 (\$60,000 selling price minus \$15,620 basis = \$44,380). In this situation, the amount of the gain representing the prior depreciation claimed, or \$34,380, will be taxed at the ordinary income rates as explained in Example 1. The remaining gain, representing the amount received in excess of the original cost of the boat, is taxed at capital gain rates. This rate is 20%, assuming you tax brackets exceed 15%.

Example 3: The same procedures apply to the sale of your license. However, whether any gain on the license is capital or ordinary will depend upon prior amortization deductions you may have claimed on the license. Fishing licenses acquired after August 10, 1993, are eligible for amortization. However, if an election was made, amortization can be claimed on property acquired after July 25, 1991. If the license was acquired before these dates, no amortization was available. See the July 2000 edition of the FIN for further information on permit amortization. If the license was acquired without cost, of course there will be nothing available to amortize. To the extent of prior amortization deductions claimed, the gain will be taxed at ordinary income rates as explained in Example 1. To the extent the sales proceeds from the license exceed your original cost, this excess will be taxed at the capital gains rate as explained in Example 2.

The sale of business assets is reported on Form 4797.

Publication 544, entitled *Sales and Other Dispositions of Assets*, provides further explanations on how to treat sales of business assets.

There is no one-year grace period to reinvest the proceeds in another business. The only way to avoid tax on the gain would be to enter into a like-kind exchange. The May edition of the FIN, as well as Publication 544, contains details on the requirements for a like-kind exchange.

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Taxpayer Assistance

Phone Numbers:

(800) 829-1040

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

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