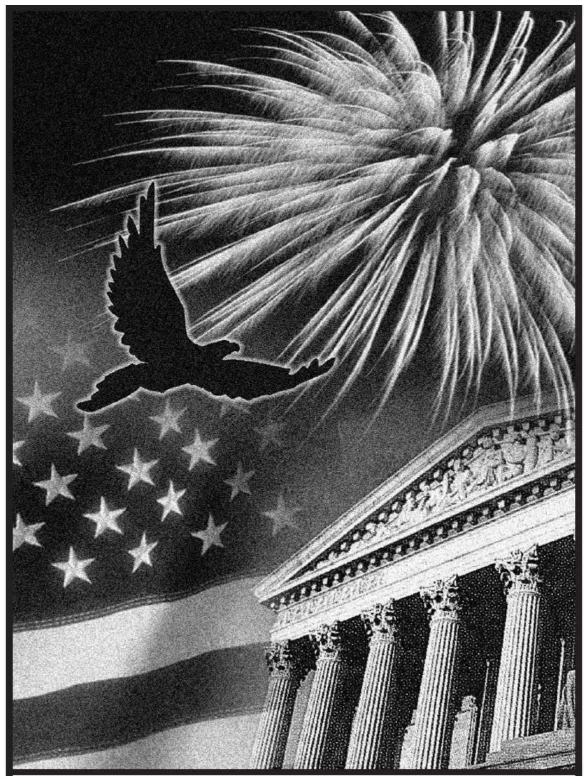
Publication 550

Investment Income and Expenses

(Including Capital Gains and Losses)

For use in preparing **2023** Returns

Volume 3 of 8



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Exception for preferred stock. In the case of preferred stock, you must have held the stock more than 90 days during the 181-day period that begins 90 days before the ex-dividend date if the dividends are due to periods totaling more than 366 days. If the preferred dividends are due to periods totaling less than 367 days, the holding period in the preceding paragraph applies.

Example 1. You bought 5,000 shares of XYZ Corp. common stock on July 5, 2023. XYZ Corp. paid a cash dividend of 10 cents per share. The ex-dividend date was July 12, 2023. Your Form 1099-DIV from XYZ Corp. shows $500 in box 1a (ordinary dividends) and in box 1b (qualified dividends). However, you sold the 5,000 shares on August 8, 2023. You held your shares of XYZ Corp. for only 34 days of the 121-day period (from July 6, 2023, through August 8, 2023). The 121-day period began on May 13, 2023 (60 days before the ex-dividend date), and ended on

September 10, 2023. You have no qualified dividends from XYZ Corp. because you held the XYZ stock for less than 61 days.

Example 2. Assume the same facts as in *Example 1* except that you bought the stock on July 11, 2023 (the day before the ex-dividend date), and you sold the stock on September 13, 2023. You held the stock for 63 days (from July 12, 2023, through September 13, 2023). The $500 of qualified dividends shown in box 1b of your Form 1099-DIV are all qualified dividends because you held the stock for 61 days of the 121-day period (from July 12, 2023, through September 13, 2023).

Example 3. You bought 10,000 shares of ABC Mutual Fund common stock on July 5, 2023. ABC Mutual Fund paid a cash dividend of 10 cents per share. The ex-dividend date was July 12, 2023. The ABC Mutual Fund advises you that the portion of the dividend eligible to be treated as qualified dividends equals 2 cents per share. Your Form 1099-DIV from ABC Mutual Fund shows total ordinary dividends of $1,000 and qualified dividends of $200. However, you sold the 10,000 shares on August 8, 2023. You have no qualified dividends from ABC Mutual Fund because you held the ABC Mutual Fund stock for less than 61 days.

Holding period reduced where risk of loss is diminished. When determining whether you met the minimum holding period discussed earlier, you cannot count any day during which you meet any of the following conditions.

1. You had an option to sell, were under a contractual obligation to sell, or had made (and not closed) a short sale of substantially identical stock or securities.
2. You were grantor (writer) of an option to buy substantially identical stock or securities.

3. Your risk of loss is diminished by holding one or more other positions in substantially similar or related property.

For information about how to apply condition (3), see Regulations section 1.246-5.

Qualified foreign corporation. A foreign corporation is a qualified foreign corporation if it meets any of the following conditions.

1. The corporation is incorporated in a U.S. territory.
2. The corporation is eligible for the benefits of a comprehensive income tax treaty with the United States that the Department of the Treasury determines is satisfactory for this purpose and that includes an exchange of information program. For a list of those treaties, see Table 1-3.
3. The corporation does not meet (1) or (2) above, but the stock for which the

dividend is paid is readily tradable on an established securities market in the United States. See *Readily tradable stock*, later.

Exception. A corporation is not a qualified foreign corporation if it is a passive foreign investment company during its tax year in which the dividends are paid or during its previous tax year.

Controlled foreign corporation (CFC). Dividends paid out of a CFC's earnings and profits that were not previously taxed are qualified dividends if the CFC is otherwise a qualified foreign corporation and the other requirements in this discussion are met. Certain dividends paid by a CFC that would be treated as a passive foreign investment company but for section 1297(d) of the Internal Revenue Code may be treated as qualified dividends. For more information, see Notice 2004-70, which can be found at *IRS.gov/irb/2004-44_IRB#NOT-2004-70*.

Readily tradable stock. Any stock or American depositary receipt in respect of that stock is considered to satisfy requirement (3) under *Qualified foreign corporation* if it is listed on a national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934 or on the Nasdaq Stock Market. For a list of the exchanges that meet these requirements, see *National Securities Exchange | Investor.gov*.

Table 1-3. **Income Tax Treaties**

Income tax treaties that the United States has with the following countries satisfy requirement (2) under *Qualified foreign corporation*.

Australia	Indonesia	Romania
Austria	Ireland	Russia
Bangladesh	Israel	Federation
Barbados	Italy	Slovak
Belgium	Jamaica	Republic
Bulgaria	Japan	Slovenia
Canada	Kazakhstan	South Africa
China	Korea	Spain
Cyprus	Latvia	Sri Lanka
Czech	Lithuania	Sweden
Republic	Luxembourg	Switzerland
Denmark	Malta	Thailand
Egypt	Mexico	Trinidad
Estonia	Morocco	and
Finland	Netherlands	Tobago
France	New Zealand	Tunisia
Germany	Norway	Turkey
Greece	Pakistan	Ukraine
Hungary	Philippines	United
Iceland	Poland	Kingdom
India	Portugal	Venezuela

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Note. The treaty with Hungary is terminated as of 2024. The treaty ceases to have effect for tax withheld at source for amounts paid or credited on or after January 1, 2024. The treaty ceases to have effect for other taxes for taxable periods beginning on or after January 1, 2024. A new treaty with Chile comes into effect in 2024. The treaty comes into effect for tax withheld at source for amounts paid or credited on or after February 1, 2024. The treaty comes into effect for other taxes for taxable periods beginning on or after January 1, 2024.

For the latest information about developments related to Pub. 550, such as tax treaties between the United States and particular countries, go to *www.IRS.gov/Pub550*.

Dividends that are not qualified dividends. The following dividends are not qualified dividends. They are not qualified dividends even if they are shown in box 1b of Form 1099-DIV.

- Capital gain distributions.
- Dividends paid on deposits with mutual savings banks, cooperative banks, credit unions, U.S. building and loan associations, U.S. savings and loan associations, federal savings and loan associations, and similar financial institutions. Report these amounts as interest income.
- Dividends from a corporation that is a tax-exempt organization or farmer's cooperative during the corporation's tax year in which the dividends were paid or during the corporation's previous tax year.
- Dividends paid by a corporation on employer securities held on the date of record by an employee stock

ownership plan (ESOP) maintained by that corporation.

- Dividends on any share of stock to the extent you are obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property.
- Payments in lieu of dividends, but only if you know or have reason to know the payments are not qualified dividends.
- Payments shown on Form 1099-DIV, box 1b, from a foreign corporation to the extent you know or have reason to know the payments are not qualified dividends.

Dividends Used To Buy More Stock

The corporation in which you own stock may have a dividend reinvestment plan. This plan lets you choose to use your dividends to buy (through an agent) more shares of stock in the corporation instead of receiving the dividends in cash. Most mutual funds also permit shareholders to automatically reinvest distributions in more shares in the fund, instead of receiving cash. If you use your dividends to buy more stock at a price equal to its fair market value, you must still report the dividends as income.

If you are a member of a dividend reinvestment plan that lets you buy more stock at a price less than its fair market value, you must report as dividend income the fair market value of the additional stock on the dividend payment date.

You also must report as dividend income any service charge subtracted from your cash dividends before the dividends are used to buy the additional stock. But you may be able to deduct the service charge.

In some dividend reinvestment plans, you can invest more cash to buy shares of stock at a price less than fair market value. If you choose to do this, you must report as dividend income the difference between the cash you invest and the fair market value of the stock you buy. When figuring this amount, use the fair market value of the stock on the dividend payment date.

Money Market Funds

Report amounts you receive from money market funds as dividend income. Money market funds are a type of mutual fund and should not be confused with bank money market accounts that pay interest.

Capital Gain Distributions

Capital gain distributions (also called capital gain dividends) are paid to you or credited to your account by mutual funds (or other regulated investment companies) and real estate investment trusts (REITs). They will be shown in box 2a of the Form 1099-DIV you receive from the mutual fund or REIT.

Report capital gain distributions as long-term capital gains, regardless of how long you owned your shares in the mutual fund or REIT. See *Capital gain distributions* under *How To Report Dividend Income*, later in this chapter.

Qualified Opportunity Fund (QOF). Effective December 22, 2017, section 1400Z-2 provides a temporary deferral of inclusion in gross income for capital gains invested in QOFs, and permanent exclusion of capital gains from the sale or exchange of an investment in the QOF if the investment is held for at least 10 years. See the Form 8949 instructions on how to report your election to defer eligible gains invested in a QOF. For additional information, please see Opportunity Zones Frequently Asked Questions available at *www.IRS.gov/Newsroom/ Opportunity-Zones-Frequently-Asked-Questions*.

Qualified Opportunity Investment. If you held a qualified investment in a qualified opportunity fund (QOF) at any time during the year, you must file your return with Form 8997, Initial and Annual Statement of Qualified Opportunity Fund Investments, attached. See Form 8997 instructions.

Undistributed capital gains of mutual funds and REITs. Some mutual funds and REITs keep their long-term capital gains and pay tax on them. You must treat your share of these gains as distributions, even though you did not actually receive them. However, they are not included on Form 1099-DIV. Instead, they are reported to you in box 1a of Form 2439.

Form 2439 also will show how much, if any, of the undistributed capital gains is:

- Unrecaptured section 1250 gain (box 1b),
- Gain from qualified small business stock (section 1202 gain, box 1c), or
- Collectibles (28%) gain (box 1d).

For information about these terms, see *Capital Gain Tax Rates* in chapter 4.

The tax paid on these gains by the mutual fund or REIT is shown in box 2 of Form 2439.

Basis adjustment. Increase your basis in your mutual fund, or your interest in a REIT, by the difference between the gain you report and the credit you claim for the tax paid.

Nondividend Distributions

A nondividend distribution is a distribution that is not paid out of the earnings and profits of a corporation or a mutual fund. You should receive a Form 1099-DIV or other statement showing you the nondividend distribution. On Form 1099-DIV, a nondividend distribution will be shown in box 3. If you do not receive such a statement, you report the distribution as an ordinary dividend.

Basis adjustment. A nondividend distribution reduces the basis of your stock. It is not taxed until your basis in the stock is fully recovered. This nontaxable portion also is called a return of capital; it is a return of your investment in the stock of the company. If you buy stock in a corporation in different lots at different times, and you cannot definitely identify the shares subject to the nondividend distribution, reduce the basis of your earliest purchases first.

When the basis of your stock has been reduced to zero, report any additional nondividend distribution you receive as a capital gain. Whether you report it as a long-term or short-term capital gain depends on how long you have held the stock. See *Holding Period* in chapter 4.

Example 1. You bought stock in 2010 for $100. In 2013, you received a nondividend distribution of $80. You did not include this amount in your income, but you reduced the basis of your stock to $20. You received a nondividend distribution of $30 in 2023. The first $20 of this amount reduced your basis to zero. You report the other $10 as a long-term capital gain for 2023. You must report as a long-term capital gain any nondividend distribution you receive on this stock in later years.

Example 2. You bought shares in XYZ Mutual Fund in 2019 for $12 per share. In 2020, you received a nondividend distribution of $5 per share. You reduced your basis in each share by $5 to an adjusted basis of $7. In 2021, you received a nondividend distribution of $1 per share and further reduced your basis in each share to $6. In 2022, you received a nondividend distribution of $2 per share. Your basis was reduced to $4 per share. In 2023, the nondividend distribution from the mutual fund was $5 per share. You reduce your basis in each share to zero and report $1 of gain per share. See the Instructions for Form 8949 for details and more information.

TIP *For more information on Form 8949 and Schedule D (Form 1040), see* Reporting Capital Gains and Losses *in chapter 4. Also, see the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040).*

Liquidating Distributions

Liquidating distributions, sometimes called liquidating dividends, are distributions you receive during a partial or complete liquidation of a corporation. These distributions are, at least in part, one form of a return of capital. They may be paid in one or more installments. You will receive Form 1099-DIV from the corporation showing you the amount of the liquidating distribution in box 9 or 10.

Any liquidating distribution you receive is not taxable to you until you have recovered the basis of your stock. After the basis of your stock has been reduced to zero, you must report the liquidating distribution as a capital gain. Whether you report the gain as a long-term or short-term capital gain depends on how long you have held the stock. See *Holding Period* in chapter 4.

Stock acquired at different times. If you acquired stock in the same corporation in more than one transaction, you own more than one block of stock in the corporation. If you receive distributions from the corporation in complete liquidation, you must divide the distribution among the blocks of stock you own in the following proportion: the number of shares in that block over the total number of shares you own. Divide distributions in partial liquidation among that part of the stock redeemed in the partial liquidation. After the basis of a block of stock is reduced to zero, you must report the part of any later distribution for that block as a capital gain.

Distributions less than basis. If the total liquidating distributions you receive are less than the basis of your stock, you may have a capital loss. You can report a capital loss only after you have received the final distribution in liquidation that results in the redemption or cancellation of the stock. Whether you report the loss as a long-term or short-term capital loss depends on how long you held the stock. See *Holding Period* in chapter 4.

Distributions of Stock and Stock Rights

Distributions by a corporation of its own stock are commonly known as stock dividends. Stock rights (also known as “stock options”) are distributions by a corporation of rights to acquire the corporation's stock. Generally, stock dividends and stock rights are not taxable to you, and you do not report them on your return.

Taxable stock dividends and stock rights. Distributions of stock dividends and stock rights are taxable to you if any of the following apply.

1. You or any other shareholder have the choice to receive cash or other property instead of stock or stock rights.
2. The distribution gives cash or other property to some shareholders and an increase in the percentage interest in the corporation's assets or earnings and profits to other shareholders.
3. The distribution is in convertible preferred stock and has the same result as in (2).
4. The distribution gives preferred stock to some common stock shareholders and common stock to other common stock shareholders.
5. The distribution is on preferred stock. (The distribution, however, is not taxable if it is an increase in the

conversion ratio of convertible preferred stock made solely to take into account a stock dividend, stock split, or similar event that would otherwise result in reducing the conversion right.)

The term “stock” includes rights to acquire stock, and the term “shareholder” includes a holder of rights or convertible securities.

If you receive taxable stock dividends or stock rights, include their fair market value at the time of distribution in your income.

Constructive distributions. You must treat certain transactions that increase your proportionate interest in the earnings and profits or assets of a corporation as if they were distributions of stock or stock rights. These constructive distributions are taxable if they have the same result as a distribution described in (2), (3), (4), or (5) of the above discussion.

This treatment applies to a change in your stock's conversion ratio or redemption price, a difference between your stock's redemption price and issue price, a redemption not treated as a sale or exchange of your stock, and any other transaction having a similar effect on your interest in the corporation.

Preferred stock redeemable at a premium. If you receive preferred stock having a redemption price higher than its issue price, the difference (the redemption premium) generally is taxable as a constructive distribution of additional stock on the preferred stock.

For stock issued before October 10, 1990, you include the redemption premium in your income ratably over the period during which the stock cannot be redeemed. For stock issued after October 9, 1990, you include the redemption premium on the basis of its economic accrual over the period during which the stock cannot be redeemed, as if it were original issue discount on a debt instrument. See *Original Issue Discount (OID)*, earlier in this chapter.

The redemption premium is not a constructive distribution, and is not taxable as a result, in the following situations.

1. The stock was issued before October 10, 1990 (before December 20, 1995, if redeemable solely at the option of the issuer), and the redemption premium is “reasonable.” (For stock issued before October 10, 1990, only the part of the redemption premium that is not “reasonable” is a constructive distribution.) The redemption premium is reasonable if it is not more than 10% of the issue price on stock not redeemable for 5 years from the issue date or is in the nature of a penalty for making a premature redemption.

2. The stock was issued after October 9, 1990 (after December 19, 1995, if redeemable solely at the option of the issuer), and the redemption premium is de minimis. The redemption premium is de minimis if it is less than one-fourth of 1% (0.0025) of the redemption price multiplied by the number of full years from the date of issue to the date redeemable.

3. The stock was issued after October 9, 1990, and must be redeemed at a specified time or is redeemable at your option, but the redemption is unlikely because it is subject to a contingency outside your control (not including the possibility of default, insolvency, etc.).

4. The stock was issued after December 19, 1995, and is redeemable solely at the option of the issuer, but the redemption premium is in the nature of a penalty for premature redemption

or redemption is not more likely than not to occur. The redemption will be treated under a “safe harbor” as not more likely than not to occur if all of the following are true.

a. You and the issuer are not related under the rules discussed in chapter 4 under *Losses on Sales or Trades of Property*, substituting “20%” for “50%.”

b. There are no plans, arrangements, or agreements that effectively require or are intended to compel the issuer to redeem the stock.

c. The redemption would not reduce the stock's yield.

Basis. Your basis in stock or stock rights received in a taxable distribution is their fair market value when distributed. If you receive stock or stock rights that are not taxable to you, see *Stocks and Bonds*, later, for information on how to figure their basis.

Fractional shares. You may not own enough stock in a corporation to receive a full share of stock if the corporation declares a stock dividend. However, with the approval of the shareholders, the corporation may set up a plan in which fractional shares are not issued but instead are sold, and the cash proceeds are given to the shareholders. Any cash you receive for fractional shares under such a plan is treated as an amount realized on the sale of the fractional shares. Report this transaction on Form 8949. Enter your gain or loss, the difference between the cash you receive and the basis of the fractional shares sold, in column (h) of Schedule D (Form 1040) in Part I or Part II, whichever is appropriate.

CAUTION *Report these transactions on Form 8949 with the correct box checked.*

For more information on Form 8949 and Schedule D (Form 1040), see *Reporting Capital Gains and Losses* in chapter 4. Also, see the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040).

Example. You own one share of common stock that you bought on January 6, 2014, for $100. The corporation declared a common stock dividend of 5% on June 30, 2023. The fair market value of the stock at the time the stock dividend was declared was $200. You were paid $10 for the fractional-share stock dividend under a plan described in the discussion above. You figure your gain or loss as follows.

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Fair market value of old stock	$200.00
Fair market value of stock dividend (cash received)	+ 10.00
Fair market value of old stock and stock dividend	$210.00
Basis (cost) of old stock after the stock dividend (($200 ÷ $210) × $100)	$95.24
Basis (cost) of stock dividend (($10 ÷ $210) × $100)	+ 4.76
Total	$100.00
Cash received	$10.00
Basis (cost) of stock dividend	– 4.76
Gain	$5.24

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Because you had held the share of stock for more than 1 year at the time the stock dividend was declared, your gain on the stock dividend is a long-term capital gain.

Scrip dividends. A corporation that declares a stock dividend may issue you a scrip certificate that entitles you to a fractional share. The certificate generally is nontaxable when you receive it. If you choose to have the corporation sell the certificate for you and give you the proceeds, your gain or loss is the difference between the proceeds and the part of your basis in the corporation's stock allocated to the certificate.

However, if you receive a scrip certificate that you can choose to redeem for cash instead of stock, the certificate is taxable when you receive it. You must include its fair market value in income on the date you receive it.

Other Distributions

You may receive any of the following distributions during the year.

Exempt-interest dividends. Exempt-interest dividends you receive from a mutual fund or other regulated investment company are not included in your taxable income. (However, see *Information reporting requirement*, next.) Exempt-interest dividends should be shown in box 12 of Form 1099-DIV.

Information reporting requirement. Although exempt-interest dividends are not taxable, you must show them on your tax return if you have to file a return. See *Reporting tax-exempt interest*, earlier.

Alternative minimum tax treatment. Exempt-interest dividends paid from specified private activity bonds may be subject to the AMT. The exempt-interest dividends subject to the AMT should be shown in box 13 of Form 1099-DIV. See Form 6251 and its instructions for more information.

Dividends on insurance policies. Insurance policy dividends the insurer keeps and uses to pay your premiums are not taxable. However, you must report as taxable interest income the interest that is paid or credited on dividends left with the insurance company.

If dividends on an insurance contract (other than a modified endowment contract) are distributed to you, they are a partial return of the premiums you paid. Do not include them in your gross income until they are more than the total of all net premiums you paid for the contract. (For information on the treatment of a distribution from a modified endowment contract, see *Distribution Before Annuity Starting Date From a Nonqualified Plan* under *Taxation of Nonperiodic Payments* in Pub. 575.) See instructions for the Form 1040 or Form 1040-SR for where to report.

Dividends on veterans' insurance. Dividends you receive on veterans' insurance policies are not taxable. In addition, interest on dividends left with the Department of Veterans Affairs is not taxable.

Patronage dividends. Generally, patronage dividends you receive in money from a cooperative organization are included in your income. You should receive Form 1099-PATR, Taxable Distributions Received from Cooperatives.

Do not include in your income patronage dividends you receive on:

- Property bought for your personal use, or
- Capital assets or depreciable property bought for use in your business. But you must reduce the basis (cost) of the items bought. If the dividend is more than the adjusted basis of the assets, you must report the excess as income.

These rules are the same whether the cooperative paying the dividend is a taxable or tax-exempt cooperative.

Alaska Permanent Fund dividends. Do not report these amounts as dividends. Instead, include these amounts on Schedule 1 (Form 1040), line 8g.

How To Report Dividend Income

Terms you may need to know (see Glossary):

Nominee

Restricted stock

Use Form 1040 or 1040-SR to report your dividend income. Report the total of your ordinary dividends on line 3b of Form 1040 or 1040-SR. Report qualified dividends on line 3a.

Form 1099-DIV. If you owned stock on which you received $10 or more in dividends and other distributions, you should receive a Form 1099-DIV. Even if you do not receive a Form 1099-DIV, you must report all your dividend income.

See Form 1099-DIV and its instructions for more information on how to report dividend income.

Form 1040 or 1040-SR. You must complete Schedule B (Form 1040), Part II, and attach it to your Form 1040 or 1040-SR, if:

- Your ordinary dividends (Form 1099-DIV, box 1a) are more than $1,500, or
- You received, as a nominee, dividends that actually belong to someone else.

If your ordinary dividends are more than $1,500, you also must complete Schedule B (Form 1040), Part III.

List on Schedule B (Form 1040), Part II, line 5, each payer's name and the ordinary dividends you received. If your securities are held by a brokerage firm (in “street name”), list the name of the brokerage firm shown on Form 1099-DIV as the payer. If your stock is held by a nominee who is the owner of record, and the nominee credited or paid you dividends on the stock, show the name of the nominee and the dividends you received or for which you were credited.

Enter on line 6 the total of the amounts listed on line 5. (However, if you hold stock as a nominee, see *Nominees*, later.) Also, enter this total on line 3b of Form 1040 or 1040-SR.

Dividends received on restricted stock. Restricted stock is stock you get from your employer for services you perform and that is nontransferable and subject to a substantial risk of forfeiture. You do not have to include the value of the stock in your income when you receive it. However, if you get dividends on restricted stock, you must include them in your income as wages, not dividends. See *Restricted Property* in Pub. 525 for information on restricted stock dividends.

Your employer should include these dividends in the wages shown on your Form W-2, Wage and Tax Statement. If you also get a Form 1099-DIV for these dividends, list them on

Schedule B (Form 1040), Part II, line 5, with the other dividends you received. Enter a subtotal of all your dividend income several rows above line 6. Below the subtotal, enter “Dividends on restricted stock reported as wages on Form 1040 or 1040-SR, line 1,” and enter the dividends included in your wages on line 1 of Form 1040 or 1040-SR. Subtract this amount from the subtotal and enter the result on line 6.

Election. You can choose to include the value of restricted stock in gross income as pay for services. If you make this choice, report the dividends on the stock like any other dividends. List them on Part II, line 5, of Schedule B (Form 1040), along with your other dividends (if the amount of ordinary dividends received from all sources is more than $1,500). If you receive both a Form 1099-DIV and a Form W-2 showing these dividends, do not include the dividends in your wages reported on line 1 of Form 1040 or 1040-SR. Attach a statement to your Form 1040 or 1040-SR explaining why the amount shown on line 1 of your Form 1040 or 1040-SR is different from the amount shown on your Form W-2.

Independent contractor. If you received restricted stock for services as an independent contractor, the rules in the previous discussion apply. Generally, you must treat dividends you receive on the stock as income from self-employment.

Qualified dividends. Report qualified dividends (Form 1099-DIV, box 1b) on line 3a of Form 1040 or 1040-SR. The amount in box 1b is already included in box 1a. Do not add the amount in box 1b to, or subtract it from, the amount in box 1a. Do not include any of the following on line 3a.

- Qualified dividends you received as a nominee. See *Nominees*, later.

- Dividends on stock for which you did not meet the holding period. See *Holding period*, earlier, under *Qualified Dividends*.
- Dividends on any share of stock to the extent you are obligated (whether under a short sale or otherwise) to make related payments for positions in substantially similar or related property.
- Payments in lieu of dividends, but only if you know or have reason to know the payments are not qualified dividends.
- Payments shown on Form 1099-DIV, box 1b, from a foreign corporation to the extent you know or have reason to know the payments are not qualified dividends.

If you have qualified dividends, you must figure your tax by completing the Qualified

Dividends and Capital Gain Tax Worksheet in the Form 1040 or 1040-SR instructions or the Schedule D Tax Worksheet in the Schedule D (Form 1040) instructions, whichever applies.

Investment interest deducted. If you claim a deduction for investment interest, you may have to reduce the amount of your qualified dividends that are eligible for the 0%, 15%, or 20% tax rate. Reduce it by the qualified dividends you choose to include in investment income when figuring the limit on your investment interest deduction. This is done on the Qualified Dividends and Capital Gain Tax Worksheet or the Schedule D Tax Worksheet. For more information about the limit on investment interest, see *Interest Expenses* in chapter 3.

Capital gain distributions. If you received capital gain distributions, you report them directly on Form 1040 or 1040-SR, line 7; or on Schedule D (Form 1040), line 13, depending on your situation. If you received capital gain distributions from a mutual fund or real estate investment trust (REIT), the distributions of net realized short-term capital gains are not treated as capital gains. Instead, they are included on Form 1099-DIV as ordinary dividends. Report them on your tax return as ordinary dividends.

Exceptions to filing Form 8949 and Schedule D (Form 1040). There are certain situations where you may not have to file Form 8949 and/or Schedule D (Form 1040).

Exception 1. You do not have to file Form 8949 or Schedule D (Form 1040) if you have no capital losses and your only capital gains are capital gain distributions from Form(s) 1099-DIV, box 2a. (If any Form(s) 1099-DIV you receive have an amount in box 2b (unrecaptured section 1250 gain), box 2c (section 1202 gain), or box 2d (collectibles (28%) gain), you do not qualify for this exception.) If you qualify for this exception, report your capital gain distributions directly on line 7 of Form 1040 or 1040-SR (and check the box). Also, use the Qualified Dividends and Capital Gain Tax Worksheet in the Form 1040 or 1040-SR instructions to figure your tax.

Exception 2. You must file Schedule D (Form 1040), but generally do not have to file Form 8949, if *Exception 1* does not apply and your only capital gains and losses are:

- Capital gain distributions;
- A capital loss carryover;
- A gain from Form 2439; Form 6252, Installment Sale Income; or Part I of Form 4797, Sales of Business Property;
- A gain or loss from Form 4684, Casualties and Thefts; Form 6781, Gains and Losses From Section 1256 Contracts and Straddles; or Form 8824;

- A gain or loss from a partnership, S corporation, estate, or trust; or
- Gains and losses from transactions for which you received a Form 1099-B that shows basis was reported to the IRS and for which you do not need to make any adjustments in column (g) of Form 8949 or enter any codes in column (f) of Form 8949.

Undistributed capital gains. Follow the Instructions for the Shareholder on Form 2439 to report undistributed capital gains and the tax paid by the mutual fund on those gains.

Nondividend distributions. Report nondividend distributions (box 3 of Form 1099-DIV) only after your basis in the stock has been reduced to zero. After the basis of your stock has been reduced to zero, you must show this excess amount on Form 8949, Part I, if you held the stock 1 year or less. Show it on Form 8949, Part II, if you held the stock for more than 1 year. Enter the name of the company in column (a) of Form 8949. Report the amount of the excess distribution in column (d) and your zero basis in column (e) of Form 8949.

Report these transactions on Form 8949 with the correct box checked.

For more information on Form 8949 and Schedule D (Form 1040), see *Reporting Capital Gains and Losses* in chapter 4. Also, see the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040).

Nominees. If you received ordinary dividends as a nominee (that is, the dividends are in your name but actually belong to someone else), include them on Part II, line 5 of Schedule B (Form 1040). Several rows above line 6, put a subtotal of all dividend income listed on line 5. Below this subtotal, enter “Nominee Distribution” and show the amount received as a nominee. Subtract the total of your nominee distributions from the subtotal. Enter the result on line 6.

If you received a capital gain distribution or were allocated an undistributed capital gain as a nominee, report only the amount that belongs to you on Form 1040 or 1040-SR, line 7; or Schedule D (Form 1040), line 13, whichever is appropriate. Attach a statement to your return showing the full amount you received or were allocated and the amount you received or were allocated as a nominee.

File Form 1099-DIV with the IRS. If you received dividends as a nominee in 2023, you must file a Form 1099-DIV (or Form 2439) for those dividends with the IRS. Send the Form 1099-DIV with a Form 1096 to your Internal Revenue Service Center by February 28, 2024 (April 1, 2024, if you file Form 1099-DIV electronically). Give the actual owner of the dividends Copy B of the Form 1099-DIV by January 31, 2024. On Form 1099-DIV, you should be listed as the "Payer." The other owner should be listed as the “Recipient.” You do not, however, have to file a Form 1099-DIV to show payments for your spouse. For more information about the reporting requirements and the penalties for failure to file (or furnish) certain information returns, see the General Instructions for Certain Information Returns and the Instructions for Form 2439.

Liquidating distributions. If you receive a liquidating distribution on stock, the corporation will give you a Form 1099-DIV showing the liquidating distribution in boxes 9 and 10.

Stripped Preferred Stock

If the dividend rights are stripped from certain preferred stock, the holder of the stripped preferred stock may have to include amounts in income equal to the amounts that would have been included if the stock were a bond with OID.

Stripped preferred stock defined. Stripped preferred stock is any stock that meets both of the following tests.

1. There has been a separation in ownership between the stock and any dividend on the stock that has not become payable.
2. The stock:
   a. Is limited and preferred as to dividends,
   b. Does not participate in corporate growth to any significant extent, and

c. Has a fixed redemption price.

Treatment of buyer. If you buy stripped preferred stock after April 30, 1993, you must include certain amounts in your gross income while you hold the stock. These amounts are ordinary income. They are equal to the amounts you would have included in gross income if the stock were a bond that:

1. Was issued on the purchase date of the stock, and
2. Has OID equal to:
    a. The redemption price for the stock, minus
    b. The price at which you bought the stock.

Include these amounts on Schedule 1 (Form 1040), line 8z.

This treatment also applies to you if you acquire the stock in such a way (for example, by gift) that your basis in the stock is determined by using a buyer's basis.

Treatment of person stripping stock. If you strip the rights to one or more dividends from preferred stock, you are treated as having purchased the stock. You are treated as making the purchase on the date you disposed of the dividend rights. Your adjusted basis in the preferred stock is treated as your purchase price. The rules described in *Treatment of buyer*, earlier, apply to you.

REMICs, FASITs, and Other CDOs

Holders of interests in real estate mortgage investment conduits (REMICs), financial asset securitization investment trusts (FASITs), and other collateralized debt obligations (CDOs) must follow special rules for reporting income and any expenses from these investment products.

REMICs

A REMIC is an entity formed for the purpose of holding a fixed pool of mortgages secured by interests in real property. A REMIC issues regular and residual interests to investors. A REMIC generally is not treated as a corporation, partnership, or trust. For purposes of subtitle F of the Internal Revenue Code (Procedure and Administration), a REMIC generally is treated as a partnership with the residual interest holders treated as the partners. The regular interests are treated as debt instruments.

REMIC income or loss is not income or loss from a passive activity.

For more information about the qualifications and tax treatment that apply to a REMIC and the interests of investors in a REMIC, see sections 860A through 860G of the Internal Revenue Code, and the regulations under those sections.

Regular Interest

A REMIC can have several classes (also known as

“tranches”) of regular interests. A regular interest unconditionally entitles the holder to receive a specified principal amount (or other similar amount).

A REMIC regular interest is treated as a debt instrument for income tax purposes. Accordingly, the OID, market discount, and income reporting rules that apply to bonds and other debt instruments as described earlier in this publication under *Discount on Debt Instruments* apply, with certain modifications discussed below.

Generally, you report your income from a regular interest on line 2b of Form 1040 or 1040-SR. For more information on how to report interest and OID, see *How To Report Interest Income*, earlier.

Holders must use accrual method. Holders of regular interests must use an accrual method of accounting to report OID and interest income. Because income under an accrual method is not determined by the receipt of cash, you may have to include OID or interest income in your taxable income even if you have not received any cash payments.

Forms 1099-INT and 1099-OID. You should receive a copy of Form 1099-INT or

Form 1099-OID from the REMIC. See the General Instructions for Certain Information

Returns for information on when you should receive your copy of Form 1099-INT or Form 1099-OID and a written statement providing additional information. The statement should contain enough information to enable you to figure your accrual of market discount or amortizable bond premium.

Form 1099-INT shows interest income that accrued to you for the period you held the regular interest.

Form 1099-OID shows OID and interest, if any, that accrued to you for the period you held the regular interest. You will not need to make any adjustments to the amounts reported even if you held the regular interest for only a part of the calendar year. However, if you bought the regular interest at a premium or acquisition premium, see *Refiguring OID shown on Form 1099-OID*, earlier.

You may not get a Form 1099. Corporations and other persons specified in Regulations section 1.6049-7(c) will not receive Forms 1099. These persons and fiscal year taxpayers may obtain tax information by contacting the REMIC or the issuer of the CDO, if they hold their interest directly from the REMIC or issuer of the CDO. Pub. 938, Real Estate Mortgage Investment Conduits (REMICs) Reporting Information, explains how to request this information.

Pub. 938 is available only on the Internet at *IRS.gov/pub938*.

If you hold a regular interest or CDO through a nominee (rather than directly), you can request the information from the nominee.

Allocated investment expenses. A single-class REMIC will report your share of its investment expenses in box 5 of Form 1099-INT or box 9 of Form 1099-OID. This amount is not deductible. A single-class REMIC is one that generally would be classified as a trust for tax purposes if it had not elected REMIC status.

Redemption of regular interests at maturity. Redemption of debt instruments at their maturity is treated as a sale or exchange. You must report redemptions on your tax return whether or not you realize gain or loss on the transaction. Your basis is your adjusted issue price, which includes any OID you previously reported in income.

Any amount you receive on the retirement of a debt instrument is treated as if you had sold or exchanged that instrument. A debt instrument is retired when it is reacquired or redeemed by the issuer and canceled.

Sale or exchange of a regular interest. Some of your gain on the sale or exchange of a REMIC regular interest may be ordinary income. The ordinary income part, if any, is:

- The amount that would have been included in your income if the yield to maturity on the regular interest had been 110% of the applicable federal rate at the beginning of your holding period, minus
- The amount you included in your income.

Residual Interest

A residual interest is an interest in a REMIC that is not a regular interest. It is designated as a residual interest by the REMIC.

If you acquire a residual interest in a REMIC, you must take into account on a quarterly basis your daily portion of the taxable income or net loss of the REMIC for each day during the tax year you hold the residual interest. You must report these amounts as ordinary income or loss.

Basis in the residual interest. Your basis in the residual interest is increased by taxable income you take into account. Your basis is decreased (but not below zero) by the cash or the fair market value of any property distributed to you, and by any net loss you have taken into account. If you sell or transfer your residual interest, you must adjust your basis to reflect your share of the REMIC's taxable income or net loss immediately before the sale or transfer. See *Wash Sales*, in chapter 4, for more information about selling a residual interest.

Treatment of distributions. You must include in your gross income the part of any distribution that is more than your adjusted basis. Treat the distribution as a gain from the sale or exchange of your residual interest.

Schedule Q (Form 1066). If you hold a REMIC residual interest, you should receive Schedule Q (Form 1066), Quarterly Notice to Residual Interest Holder of REMIC Taxable Income or Net Loss Allocation, and instructions from the REMIC each quarter.

Schedule Q (Form 1066) will indicate your share of the REMIC's quarterly taxable income (or loss). Do not attach Schedule Q (Form 1066) to your tax return. Keep it for your records.

Use Schedule E (Form 1040), Part IV, to report your total share of the REMIC's taxable income (or loss) for each quarter included in your tax year.

For more information about reporting your income (or loss) from a residual interest in a REMIC, follow the Instructions for Schedule Q (Form 1066) and Schedule E (Form 1040).

Collateralized Debt Obligations (CDOs)

A CDO is a debt instrument, other than a REMIC regular interest, that is secured by a pool of mortgages or other evidence of debt and that has principal payments subject to acceleration. (**Note:** While REMIC regular interests are collateralized debt obligations, they have unique rules that do not apply to CDOs issued before 1987.) CDOs, also known as “pay-through bonds,” are commonly divided into different classes (also called “tranches”).

CDOs can be secured by a pool of mortgages, automobile loans, equipment leases, or credit card receivables.

For more information about the qualifications and the tax treatment that apply to an issuer of a CDO, see section 1272(a)(6) of the Internal Revenue Code and the regulations under that section.

The OID, market discount, and income-reporting rules that apply to bonds and other debt instruments, as described earlier in this chapter under *Discount on Debt Instruments*, also apply to a CDO.

You must include interest income from your CDO in your gross income under your regular method of accounting. Also, include any OID accrued on your CDO during the tax year.

Generally, you report your income from a CDO on line 2b of Form 1040 or 1040-SR. For more information about reporting these amounts on your return, see *How To Report Interest Income*, earlier.

Forms 1099-INT and 1099-OID. You should receive a copy of Form 1099-INT or Form 1099-OID generally by January 31, 2024. See the General Instructions for Certain Information Returns for information on when you should receive your copy of Form 1099-INT or Form 1099-OID and a written statement providing additional information. The statement should contain enough information about the CDO to enable you to figure your accrual of market discount or amortizable bond premium.

Form 1099-INT shows the interest income paid to you for the period you held the CDO.

Form 1099-OID shows the OID accrued to you and the interest, if any, paid to you for the period you held the CDO. You should not need to make any adjustments to the amounts reported even if you held the CDO for only a part of the calendar year. However, if you bought the CDO at a premium or acquisition premium, see *Refiguring OID shown on Form 1099-OID*, earlier.

If you did not receive a Form 1099, see *You may not get a Form 1099*, earlier.

FASITs

A financial asset securitization investment trust (FASIT) is an entity that securitizes debt obligations such as credit card receivables, home equity loans, and automobile loans.

A regular interest in a FASIT is treated as a debt instrument. The rules described under *Collateralized Debt Obligations (CDOs)*, earlier, apply to a regular interest in a FASIT, except that a holder of a regular interest in a

FASIT must use an accrual method of accounting to report OID and interest income.

For more information about FASITs, see sections 860H through 860L of the Internal Revenue Code.

Beginning January 1, 2005, the special rules for FASITs are repealed. However, the special rules still apply to any FASIT in existence on October 22, 2004, to the extent that regular interests issued by the FASIT before that date continue to remain outstanding in accordance with the original terms of issuance.

S Corporations

In general, an S corporation does not pay a tax on its income. Instead, its income and expenses are passed through to the shareholders, who then report these items on their own income tax returns.

If you are an S corporation shareholder, your share of the corporation's current year income or loss and other tax items are taxed to you whether or not you receive any amount. Generally, those items increase or decrease the basis of your S corporation stock, as appropriate. For more information on basis adjustments for S corporation stock, see *Stocks and Bonds*, later.

Generally, S corporation distributions, except dividend distributions, are considered a return of capital and reduce your basis in the stock of the corporation. The part of any distribution that is more than your basis is treated as a gain from the sale or exchange of property. The corporation's distributions may be in the form of cash or property.

S corporation distributions are not treated as dividends except in certain cases in which the corporation has accumulated earnings and profits from years before it became an S corporation.

Reporting S corporation income, deductions, and credits. The S corporation should send you a copy of Schedule K-1 (Form 1120S) showing your share of the S corporation's income, credits, and deductions for the tax year. You must report your distributive share of the S corporation's income, gain, loss, deductions, or credits on the appropriate lines and schedules of your Form 1040 or 1040-SR.

For more information about your treatment of S corporation tax items, see Shareholder's Instructions for Schedule K-1 (Form 1120S).

Limit on losses and deductions. The deduction for your share of losses and deductions shown on Schedule K-1 (Form 1120S) is limited to the adjusted basis of your stock and any debt the corporation owes you. Any loss or deduction not allowed because of this limit is carried over and treated as a loss or deduction in the next tax year.

Passive activity losses. Rules apply that limit losses from passive activities. Your copy of Schedule K-1 (Form 1120S) and its instructions will explain the limits and tell you where on your return to report your share of S corporation items from passive activities.

Form 8582. If you have a passive activity loss from an S corporation, you must complete Form 8582 to figure the allowable loss to enter on your return. See Pub. 925 for more information.

Investment Clubs

An investment club is formed when a group of friends, neighbors, business associates, or others pool their money to invest in stock or other securities. The club may or may not have a written agreement, a charter, or bylaws.

Usually, the group operates informally with members pledging to pay a monthly regular amount into the club. Some clubs have a committee that gathers information on securities, selects the most promising securities, and recommends that the club invest in them. Other clubs rotate these responsibilities among all their members. Most clubs require all members to vote for or against all investments, sales, trades, and other transactions.

Identifying number. Each club must have an EIN to use when filing its return. The club's EIN also may have to be given to the payer of dividends or other income from investments recorded in the club's name. To obtain an EIN, apply online at *IRS.gov/Businesses/Small-Businesses-&Self-Employed/Apply-for-an-Employer-IdentificationNumber-(EIN)-Online* or file Form SS-4, Application for Employer Identification Number. See chapter 5, *How To Get Tax Help*, for more information about how to get this form.

Investments in name of member. When an investment is recorded in the name of one club member, this member must give its SSN to the payer of investment income. (When an investment is held in the names of two or more club members, the SSN of only one member must be given to the payer.) This member is considered the record owner for the actual owner, the investment club. This member is a “nominee” and must file an information return with the IRS. For example, the nominee member must file Form 1099-

DIV for dividend income, showing the club as the owner of the dividend, its SSN, and the EIN of the club.

Tax Treatment of the Club

Generally, an investment club is treated as a partnership for federal tax purposes unless it chooses otherwise. In some situations, however, it is taxed as a corporation or a trust.

Clubs formed before 1997. Before 1997, the rules for determining how an investment club is treated were different from those explained in the following discussions. An investment club that existed before 1997 is treated for later years the same way it was treated before 1997, unless it chooses to be treated a different way under the new rules. To make that choice, the club must file Form 8832, Entity Classification Election.

Club as a Partnership

If your club is not taxed as a corporation or a trust, it will be treated as a partnership.

Filing requirement. If your investment club is treated as a partnership, it must file Form 1065, U.S. Return of Partnership Income. However, as a partner in the club, you must report on your individual return your share of the club's income, gains, losses, deductions, and credits for the club's tax year. (Its tax year generally must be the

same tax year as that of the partners owning a majority interest.) You must report these items whether or not you actually receive any distribution from the partnership.

Schedule K-1 (Form 1065). You should receive a copy of Schedule K-1 (Form 1065) from the partnership. The amounts shown on Schedule K-1 (Form 1065) are your share of the partnership's income, deductions, and credits. Report each amount on the appropriate lines and schedules of your income tax return.

The club's expenses for producing or collecting income, for managing investment property, or for determining any tax are listed separately on Schedule K-1 (Form 1065).

For more information about reporting your income from a partnership, see the Schedule K-1 (Form 1065) instructions. Also, see Pub. 541, Partnerships.

Passive activity losses. Rules apply that limit losses from passive activities. Your copy of Schedule K-1 (Form 1065) and its instructions will tell you where on your return to report your share of partnership items from passive activities. If you have a passive activity loss from a partnership, you must complete Form 8582 to figure the amount of the allowable loss to enter on your tax return.

No social security coverage for investment club earnings. If an investment club partnership's activities are limited to investing in savings certificates, stock, or securities, and collecting interest or dividends for its members' accounts, a member's share of income is not earnings from self-employment. You cannot voluntarily pay the self-employment tax to increase your social security coverage and ultimate benefits.

Club as a Corporation

An investment club formed after 1996 is taxed as a corporation if:

- It is formed under a federal or state law that refers to it as incorporated or as a corporation, body corporate, or body politic;
- It is formed under a state law that refers to it as a joint-stock company or joint-stock association; or
- It chooses to be taxed as a corporation.

Choosing to be taxed as a corporation. To choose to be taxed as a corporation, the club cannot be a trust (see *Club as a Trust*, later)

or otherwise subject to special treatment under the tax law. The club must file Form 8832 to make the choice.

Filing requirement. If your club is taxed as a corporation, it must file Form 1120, U.S. Corporation Income Tax Return. In that case, you do not report any of its income or expenses on your individual return. All ordinary income and expenses and capital gains and losses must be reported on the Form 1120. Any distribution the club makes that qualifies as a dividend must be reported on Form 1099-DIV if total distributions to the shareholder are $10 or more for the year.

You must report any distributions you receive from the club on your individual return. You should receive a copy of Form 1099-DIV from the club showing the distributions you received.

Some corporations can choose not to be taxed and have earnings taxed to the shareholders. See *S Corporations*, earlier.

For more information about corporations, see Pub. 542, Corporations.

Club as a Trust

In a few cases, an investment club is taxed as a trust. In general, a trust is an arrangement through which trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. An arrangement is treated as a trust for tax purposes if its purpose is to vest in trustees responsibility for protecting and conserving property for beneficiaries who cannot share in that responsibility and so are not associates in a joint enterprise for the conduct of business for profit. If you need more information about trusts, see Regulations section 301.7701-4.

Filing requirement. If your club is taxed as a trust, it must file Form 1041, U.S. Income Tax Return for Estates and Trusts. You should receive a copy of Schedule K-1 (Form 1041) from the trust. Report the amounts shown on Schedule K-1 (Form 1041) on the appropriate lines and schedules of your income tax return.

2.

Tax Shelters and Other Reportable Transactions

Introduction

Investments that yield tax benefits are sometimes called “tax shelters.” In some cases, Congress has concluded that the loss of revenue is an acceptable side effect of special tax provisions designed to encourage taxpayers to make certain types of investments. In many cases, however, losses from tax shelters produce little or no benefit to society, or the tax benefits are exaggerated beyond those intended. Those cases are called “abusive tax shelters.” An investment that is considered a tax shelter is subject to restrictions, including the requirement that it be disclosed. See *Disclosure of reportable transactions*, later.

Topics

This chapter discusses:

- Abusive Tax Shelters,
- Rules To Curb Abusive Tax Shelters,
- Investor Reporting,
- Penalties, and
- Whether To Invest.

Useful Items

You may want to see:

Publication

- ☐ **538** Accounting Periods and Methods
- ☐ **561** Determining the Value of Donated Property
- ☐ **925** Passive Activity and At-Risk Rules

Form (and Instructions)

- ☐ 8275 Disclosure Statement

☐ **8275-R** Regulation Disclosure Statement

☐ **8283** Noncash Charitable Contributions

☐ **8865** Return of U.S. Persons With Respect to Certain Foreign Partnerships

☐ **8886** Reportable Transaction Disclosure Statement

☐ **8918** Material Advisor Disclosure Statement

☐ **8938** Statement of Specified Foreign Financial Assets

See chapter 5, *How To Get Tax Help*, for information about getting these publications and forms.

Abusive Tax Shelters

Abusive tax shelters are marketing schemes involving artificial transactions with little or no economic reality. They often make use of unrealistic allocations, inflated appraisals, losses in connection with nonrecourse loans, mismatching of income and deductions, financing techniques that do not conform to standard commercial business practices, or mischaracterization of the substance of the transaction. Despite appearances to the contrary, the taxpayer generally risks little.

Abusive tax shelters commonly involve package deals designed from the start to generate losses, deductions, or credits that will be far more than the present or future investment. For example, abusive tax shelters may promise investors from the start that future inflated appraisals will enable them to deduct charitable contribution deductions based on those appraisals. (But see the appraisal requirements discussed under *Rules*

To Curb Abusive Tax Shelters, later.) They are commonly marketed in terms of the ratio of tax deductions allegedly available to each dollar invested. This ratio (or “write-off”) is frequently said to be several times greater than one-to-one.

Because there are many types of abusive tax shelters, it is not possible to list all the factors you should consider in determining whether an offering is an abusive tax shelter. However, you should ask the following questions, which might provide a clue to the abusive nature of the plan.

- Do the tax benefits far outweigh the economic benefits? Are the tax benefits the primary reason for the transaction?
- Is this a transaction you would seriously consider if you hoped to make a profit?

- Do shelter assets really exist and, if so, are they insured for less than their purchase price?
- Is there a nontax justification for the way profits and losses are allocated to partners?
- Do the facts and supporting documents make economic sense? For example, are there sales and resales of the tax shelter property at ever increasing prices?
- Does the investment plan involve a gimmick, device, or sham to hide the economic reality of the transaction?
- Does the promoter offer to backdate documents? Are you instructed to backdate checks covering your investment?
- Is your debt a real debt or are you assured by the promoter that you will never have to pay it?

- Does this transaction involve laundering U.S. source income through foreign corporations incorporated in a tax haven and owned by U.S. shareholders?

Rules To Curb Abusive Tax Shelters

Congress has enacted a series of income tax laws designed to halt the growth of abusive tax shelters. These provisions include the following.

Disclosure of reportable transactions. You must disclose information for each reportable transaction in which you participate. See *Reportable Transaction Disclosure Statement*, later.

Material advisors with respect to any reportable transaction must disclose information about the transaction on Form 8918, Material Advisor Disclosure Statement. To determine whether you are a material advisor to a transaction, see the Instructions for Form 8918.

Material advisors will receive a reportable transaction number for the disclosed reportable transaction. They must provide this number to all persons to whom they acted as a material advisor. They must provide the number at the time the transaction is entered into. If they do not have the number at that time, they must provide it within 60 days from the date the number is mailed to them. For information on penalties for failure to disclose and failure to maintain lists, see sections 6707, 6707A, and 6708.

Requirement to maintain list. Material advisors must maintain a list of persons to whom they provide material aid, assistance, or advice on any reportable transaction. The list must be available for inspection by the IRS, and the information required to be included on the list must generally be kept for

7 years. See Regulations section 301.6112-1 for more information (including what information is required to be included on the list).

Confidentiality privilege. The confidentiality privilege between you and a federally authorized tax practitioner does not apply to written communications made after October 21, 2004, regarding the promotion of your direct or indirect participation in any tax shelter.

Appraisal requirement for donated property. If you claim a deduction of more than $5,000 for an item or group of similar items of donated property, you must generally get a qualified appraisal. See section 170 and Form 8283 for more information. If you claim a deduction of more than $500,000 for the donated property, you must generally attach the qualified appraisal to your return. If you file electronically, see Form 8453, U.S. Individual Income Tax

Transmittal for an IRS *e-file* Return, and its instructions. See Pub. 561 for information about appraisals.

Passive activity loss and credit limits. The passive activity loss and credit rules limit the amount of losses and credits that can be claimed from passive activities and limit the amount that can offset nonpassive income, such as certain portfolio income from investments. See Pub. 925 for information about income, losses, and credits from passive activities.

Interest on penalties. If you are assessed an accuracy-related or civil fraud penalty (as discussed under *Penalties*, later), interest will be imposed on the amount of the penalty from the due date of the return (including any extensions) to the date you pay the penalty.

Accounting method restriction. Tax shelters generally cannot use the cash method of accounting.

Uniform capitalization rules. The uniform capitalization rules generally apply to producing property or acquiring it for resale. Under those rules, the direct cost and part of the indirect cost of the property must be capitalized or included in inventory. See Pub. 538 for uniform capitalization rules.

Denial of deduction for interest on an underpayment due to a reportable transaction. You cannot deduct any interest you paid or accrued on any part of an underpayment of tax due to an understatement arising from a reportable transaction if the relevant facts affecting the tax treatment of the item are not adequately disclosed. See *Reportable transaction*, later. This rule applies to reportable transactions entered into in tax years beginning after October 22, 2004.

Authority for Disallowance of Tax Benefits

The IRS has published guidance concluding that the claimed tax benefits of various abusive tax shelters should be disallowed. The guidance is the IRS’s conclusion on how the law is applied to a particular set of facts. Guidance is published in the Internal Revenue Bulletin for taxpayers' information and also for use by IRS officials. So, if your return is examined and an abusive tax shelter is identified and challenged, published guidance dealing with that type of shelter, which disallows certain claimed tax shelter benefits, could serve as the basis for the examining official's challenge of the tax benefits you claimed. In such a case, the examiner will not compromise even if you or your representative believe you have authority for the positions taken on your tax return. In addition, the examiner can also assess penalties based on the facts and circumstances.

The courts are generally unsympathetic to taxpayers involved in abusive tax shelter schemes and have ruled in favor of the IRS in the majority of the cases in which these shelters have been challenged.

Investor Reporting

You may be required to file a reportable transaction disclosure statement.

Reportable Transaction Disclosure Statement

Use Form 8886 to disclose information for each reportable transaction in which you participated. See *Reportable transaction*, later. Generally, you must attach Form 8886 to your return for each tax year in which you participated in the transaction. Under certain circumstances, a transaction must be disclosed within 90 days of the transaction being identified as a listed transaction or a transaction of interest. See *Listed transaction*, later. In addition, for the first year Form 8886 is attached to your return, you must send a copy of the form to:

Internal Revenue Service
OTSA Mail Stop 4915
1973 Rulon White Blvd.
Ogden, UT 84201

If you file your return electronically, the copy sent to The Office of Tax Shelter Analysis (OTSA) must show exactly the same information, word for word, provided with the electronically filed return and it must be provided on the official IRS Form 8886 or an exact copy of the form. If you use a computer-generated or substitute Form 8886, it must be an exact copy of the official IRS form.

If you fail to file Form 8886 as required or fail to include any required information on the form, you may have to pay a penalty. See *Penalty for failure to disclose a reportable transaction*, later.

The following discussion briefly describes reportable transactions. For more details, see the Instructions for Form 8886.

Reportable transaction. A reportable transaction is any of the following.

- A listed transaction.
- A confidential transaction.
- A transaction with contractual protection.
- A loss transaction.
- A transaction of interest entered into after November 1, 2006.

Note. Transactions with a brief asset holding period were removed from the definition of reportable transaction for transactions entered into after August 2, 2007.

Listed transaction. A listed transaction is the same as, or substantially similar to, one of the types of transactions the IRS has determined to be a tax-avoidance transaction. These transactions have been identified in notices, regulations, and other published guidance issued by the IRS.

For more information, go to *Abusive Tax Shelters and Transactions,* where you will find a link to a list of listed transactions.