

DRAFT INTRODUCTION
OF
LAW AND ANALYSIS
FOR
IRS RULING REQUEST

December 21, 2016

In response to members' request for guidance regarding the filing of their 2016 Federal Tax Returns, we are providing a copy of the STATEMENT OF LAW & ANALYSIS prepared by the attorney retained by the Retired Firefighters Association (RFA) to petition the Internal Revenue Service (IRS) for a Private Ruling on whether the forgiveness of past overpayments by the Treasury Department's, Office of D.C. Pensions is indeed taxable income within the meaning of the Federal Tax Code.

This document may be shared with the tax preparer handling your 2016 Federal Return. The requested ruling is premised on the fact that the taxpayer requesting the ruling had properly reported, on his/her prior federal income tax returns, all income received by him/her on Form 1099-R for years in which he received distributions from the Office of D.C. Pensions. It is intended to provide you with an argument framed by counsel. The Ruling has not been received but this information may assist your tax preparer in determining how the 1099-C you have received should be treated within your tax filing.

Should you or your tax preparer, wish to contact Mr. Frost for additional consultation, you may do so. However, any fees or costs related are the responsibility of the member who seeks Mr. Frost's individual assistance.

The applicable pages referred to above are attached.

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B. RULING REQUESTED

The Taxpayer requests a ruling that he realized no income with respect to the amount that will be reported to him on 2016 Form 1099-C from ODCP because the repayment of such amount would have given rise to a deduction under either § 162, 165, or 1341 and section 108(e)(2) therefore applies to prevent realization of income from the cancellation of the debt.⁵

C. STATEMENT OF LAW & ANALYSIS

Section 402(a) provides that any amount actually distributed to any distributee from a qualified plan described in section 401(a) will be taxable to the distributee in the taxable year of distribution under section 72 (relating to annuities).

Section 165(a) provides that there shall be allowed as a deduction any loss sustained during the taxable year that is not compensated by insurance or otherwise. Section 165(c) limits the deduction under section 165(a) for individuals to losses incurred in a trade or business, losses incurred in transactions entered into for profit, and casualty losses. The performance of services as an employee is the carrying on of a trade or business. (See Rev. Rul. 79-322, 1979-2 C.B. 76, and Rev. Rul. 82-178, 1982-2 C.B. 59.)

Section 67(a) provides that in the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2-percent of adjusted gross income.

Section 451(a) provides that the amount of any item of gross income shall be included in the taxable year in which received by the taxpayer unless the amount is to be properly accounted for in a different period.

Section 1.451-1(a) of the Income Tax Regulations provides that under the cash receipts and disbursements method of accounting, an item of income is included in gross income for the taxable year in which such item is actually or constructively received.

Section 1341(a) provides rules for the computation of tax where a taxpayer is entitled to a deduction in excess of \$3,000 as a result of restoring an amount included in gross income for a prior taxable year because it appeared that the taxpayer had an unrestricted right to such amount. The amount of the tax imposed on the taxpayer under section 1341 is the lesser of the tax for the taxable year computed with the deduction or an amount equal to the tax for the taxable year computed without the deduction but minus the decrease in tax for the prior tax year or years after excluding the income. Under section 67(b)(9), a deduction under section 1341 is not a miscellaneous itemized deduction subject to the 2-percent adjusted gross income floor of section 67(a).

⁵ The Taxpayer asserts in the alternative that if the Overpayment does not give rise to an "obligation" or "debt" then there is no cancellation of indebtedness income. See *Zarin v. Commissioner*, 916 F.2d 110 (3rd Cir. 1990).

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Rev. Rul. 82-178 holds that repayment of amounts by a rehired employee in order that certain employee benefits would be restored to the level that they were at the time the rehired employee was laid off is a loss incurred under section 165(c)(1).

Rev. Rul. 79-322 holds that a repayment of amounts received by an employee for sick leave that was includible in the employee's gross income in a prior taxable year is deductible as a business loss under section 165.

Rev. Rul. 2002-84 holds that when an individual repays in the current year an overpayment made by a qualified retirement plan in a previous year, the amount actually paid in the previous year was properly included in gross income. The amount of the repayment is deductible under section 165(a). If the repayment amount exceeds \$3,000, then the rules of section 1341 would apply in determining the taxpayer's income tax liability for year in which repayment was made. In applying the rules of section 1341, the deduction is determined without regard to the 2-percent floor as provided under section 67(b)(9).

Sections 402(a) and 403(a) specifically address the tax treatment of distributions from qualified retirement plans. Under these provisions, amounts payable under a qualified retirement plan are included in gross income of the participant in the taxable year of distribution. The amounts are taxable to a distributee at the time of receipt, even though the distributee may be later obligated to repay amounts attributable to a plan overpayment in subsequent taxable years, either by direct payment or by payment reduction. Consequently, in Situations (1), (2), and (3), the amounts attributable to a plan overpayment are distributions taxable under section 402(a) in the year of receipt.

Rev. Rul. 2002-84 explains that for overpayments repaid to a qualified retirement plan in a taxable year or years subsequent to the year of the overpayment, a participant would be entitled to a deduction under section 165(a) because the amount of the plan overpayment is attributable to compensation for services rendered to the employer. The deduction is allowable in the year that the single-sum repayment is paid by the taxpayer, but only if the taxpayer itemizes his deductions. A deduction under section 165(a) for an individual with losses that are incurred in a trade or business is considered a miscellaneous itemized deduction and, thus, is subject to the 2-percent floor established under section 67(a) for miscellaneous itemized deductions. However, if the amount of the distribution instead exceeded the amount that was due to the employee by more than \$3,000, the rules of section 1341 would apply in determining the taxpayer's income tax liability for year in which repayment was made. In applying the rules of section 1341, the deduction is determined without regard to the 2-percent floor as provided under section 67(b)(9).

Section 108(e)(2) provides that no income is realized from the discharge of indebtedness if payment of the liability would have given rise to a deduction.

D. CONCLUSION

Under section 162, 165, or 1341, the Taxpayer would have been able to claim a deduction if he had repaid the Overpayment to ODCP. As a result, the amount to be reported to him on

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Form 1099-C would not be realized as income because of section 108(e)(2). This result is consistent with the fact that the Taxpayer has already included the Overpayment on his income tax returns (i.e., annual inclusion of income from Form 1099-R) and paid the resulting tax. The forgiveness of the debt should not give rise to income a second time.

E. PROCEDURAL MATTERS

Revenue Procedure 2014-4 Statements

1. To the best of the knowledge of both the taxpayer and the taxpayer's representatives:
 - A. The same issue is not in an earlier return of the taxpayer.
 - B. The Service has not ruled on the same or similar issue for the taxpayer or a predecessor.
2. Administrative
 - A. A Power of Attorney is enclosed.
 - B. The deletions statement and checklist required by Revenue Procedure 2014-4 are enclosed.
 - C. The required user fee is enclosed.

Sincerely,

By:

Glen E. Frost, Esq.

Date