

CHAPTER 8007
DEPARTMENT OF REVENUE
INCOME AND FRANCHISE TAXES
ACCOUNTING METHODS; TAXABLE YEAR

8007.0300 RESTORATION OF AMOUNTS RECEIVED OR ACCRUED UNDER CLAIM OF RIGHT.

8007.0100 [Repealed, L 1987 c 268 art 1 s 128]

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8007.0300 RESTORATION OF AMOUNTS RECEIVED OR ACCRUED UNDER CLAIM OF RIGHT.

Subpart 1. **In general.** If, during the taxable year, the taxpayer is entitled under other provisions of Minnesota Statutes, chapter 290 to a deduction of more than \$3,000 because of the restoration to another of an item which was included in the taxpayer's gross income for a prior taxable year (or years) under a claim of right, the tax imposed by Minnesota Statutes, chapter 290 for the taxable year shall be the tax provided in subpart 2.

For the purpose of this part "income included under a claim of right" means an item included in gross income because it appeared from all the facts available in the year of inclusion that the taxpayer had an unrestricted right to such item, and "restoration to another" means a restoration resulting because it was established after the close of such prior taxable year (or years) that the taxpayer did not have an unrestricted right to such item (or portion thereof).

For purposes of determining whether the amount of a deduction described in Minnesota Statutes, section 290.07, subdivision 4 exceeds \$3,000 for the taxable year, there shall be taken into account the aggregate of all such deductions with respect to each item of income (described in Minnesota Statutes, section 290.07, subdivision 4 of the same class).

Subp. 2. **Determination of tax.** Under the circumstances described in subpart 1, the tax imposed by Minnesota Statutes, chapter 290 for the taxable year shall be the lesser of:

A. the tax for the taxable year computed under Minnesota Statutes, section 290.07, subdivision 4 that is, with the deduction taken into account; or

B. the tax for the taxable year computed without taking such deduction into account, minus the decrease in tax under Minnesota Statutes, chapter 290 for the prior taxable year (or years) which would result solely from the exclusion from gross income of all or that portion of the income included under a claim of right to which the deduction is attributable.

For the purpose of this subpart, the amount of the decrease in tax is not limited to the amount of the tax for the taxable year. See item A where the decrease in tax for the prior taxable year (or years) exceeds the tax for the taxable year.

If the taxpayer computes the tax for the taxable year under item B, the amount of the restoration shall not be taken into account in computing taxable income or loss for the taxable year, including the computation of any net operating loss carryback or carryover or any capital loss carryover.

If the tax determined under item A is the same as the tax determined under item B, the tax imposed for the taxable year under Minnesota Statutes, chapter 290 shall be the tax determined under item A, and this part shall not otherwise apply.

Subp. 3. [Repealed, L 2003 c 127 art 3 s 24]

Subp. 4. **Determination of decrease in tax for prior taxable years.** The prior taxable year (or years) referred to in subpart 2 is the year (or years) in which the item to which the deduction is attributable was included in gross income under a claim of right and, in addition, any other prior taxable year (or years) the tax for which will be affected by the exclusion from gross income in such prior taxable year (or years) of such income.

A. The amount to be excluded from gross income for the prior taxable year (or years) in determining the decrease in tax under subpart 2, item B, shall be the amount restored in the taxable year, but shall not exceed the amount included in gross income in the prior taxable year (or years) under the claim of right to which the deduction for the restoration is attributable, and shall be adjusted as provided in item B.

B. If the amount included in gross income for the prior taxable year (or years) under the claim of right in question was reduced in such year (or years) by a deduction allowed under Minnesota Statutes, section 290.16, subdivision 4 then the amount determined under item A to be excluded from gross income for such year (or years) shall be reduced in the same proportion that the amount included in gross income under a claim of right was reduced.

C. The determination of the amount of the exclusion from gross income of the prior taxable year shall be made without regard to the capital loss limitation contained in Minnesota Statutes, section 290.16, subdivision 5 applicable in computing taxable income for the current taxable year. The amount of the exclusion from gross income in a prior taxable year (or years) shall not exceed the amount which would, but for the application of Minnesota Statutes, section 290.16, subdivision 5, be allowable as a deduction in the taxable year of restoration.

D. The rule provided in item C may be illustrated as follows: For the taxable year 1957, an individual taxpayer had long-term capital gains of \$50,000 and long-term capital losses of \$10,000, a net long-term gain of \$40,000. The taxpayer also had other income of \$5,000. In 1961 taxpayer restored the \$50,000 of long-term gain. The taxpayer had no capital gains or losses in 1961 but had other income of \$5,000. If the tax liability for 1961, the taxable year of restoration, is computed by taking the deduction into account, the taxpayer would be entitled to a deduction under Minnesota Statutes, section 290.16, subdivision 5 of only \$1,000 on account of the capital loss. However, if the taxpayer computes the tax under subpart 2, item B, it is necessary to determine the decrease in tax for 1957. In such a determination, \$50,000 is to be excluded from gross income for that year, resulting in a net capital loss for that year of \$10,000, and a capital loss deduction of \$1,000 under Minnesota Statutes, section 290.16, subdivision 5 with carryover privileges. The difference between the tax previously determined and the tax as recomputed after such exclusion for the years affected will be the amount of the decrease.

E. If the deduction otherwise allowable for the taxable year relates to income included in gross income under a claim of right in more than one prior taxable year and the amount attributable to each such prior taxable year cannot be readily identified, then the portion attributable to each such prior taxable year shall be that portion of the deduction otherwise allowable for the taxable year which the amount of the

income included under the claim of right in question for the prior taxable year bears to the total of all such income included under the claim of right for all such prior taxable years.

The rule provided in this item may be illustrated as follows: Under a claim of right, A included in gross income over a period of three taxable years an aggregate of \$9,000 for services to a certain employer, in amounts as follows: \$2,000 for taxable year 1952, \$4,000 for taxable year 1953, and \$3,000 for taxable year 1954. In 1955 it is established that A must restore \$6,750 of these amounts to A's employer, and that A is entitled to a deduction of this amount in the taxable year 1955. The amount of the deduction attributable to each of the prior taxable years cannot be identified. Accordingly, the amount of the deduction attributable to each prior taxable year is:

$$\begin{array}{r}
 \$2,000 \\
 1952 - \$6,750 \quad X \quad \frac{\quad}{\$9,000} = \$1,500 \\
 \\
 \$4,000 \\
 1953 - \$6,750 \quad X \quad \frac{\quad}{\$9,000} = \$3,000 \\
 \\
 \$3,000 \\
 1954 - \$6,750 \quad X \quad \frac{\quad}{\$9,000} = \$2,250
 \end{array}$$

F. In computing the amount of decrease in tax for a prior taxable year (or years) resulting from the exclusion from gross income of the income included under a claim of right, there must first be ascertained the amount of tax previously determined for the taxpayer for such prior taxable year (or years). The tax previously determined shall be the sum of the amounts shown by the taxpayer on the return or returns, plus any amounts which have been previously assessed (or collected without assessment) as deficiencies or which appropriately should be assessed or collected, reduced by the amount of any refunds or credits which have previously been made or which appropriately should be made. After the tax previously determined has been ascertained, a recomputation must then be made to determine the decrease in tax, if any, resulting from the exclusion from gross income of all or that portion of the income included under a claim of right to which the deduction otherwise allowable in the taxable year is attributable.

No item other than the exclusion of the income previously included under a claim of right shall be considered in computing the amount of decrease in tax if reconsideration of such other item is prevented by the operation of any provision of the income tax laws or any other rule of law. However, if the amounts of other items in the return are dependent upon the amount of adjusted gross income, taxable income, or net income (such as charitable contributions, foreign tax credit, deductions for depletion, and net operating loss), appropriate adjustment shall be made as part of the computation of the decrease in tax. For the purpose of determining the decrease in tax for the prior taxable year (or years) which would result from the exclusion from gross income of the item included under a claim of right, the exclusion of such item shall be given effect not only in the prior taxable year in which it was included in gross income but in all other prior taxable

years affected by the inclusion of the item (for example, prior taxable years affected by a net operating loss carryback or carryover or capital loss carryover).

The rules provided in this item may be illustrated as follows:

Example 1. For the taxable year 1954, a corporation has taxable income of \$35,000, on which it paid a tax of \$2,000. Included in gross income for the year was \$20,000 received under a claim of right as royalties. In 1957, the corporation is required to return \$10,000 of the royalties. It otherwise has taxable income in 1957 of \$5,000, so that without the application of Minnesota Statutes, section 290.07, subdivision 4 it has a net operating loss of \$5,000 in that year.

Facts also come to light in 1957 which entitle the corporation to an additional deduction of \$5,000 for 1954. When a computation is made under subpart 2, item A, the corporation has no tax for the taxable year 1957. When a computation is made under subpart 2, item B, the tax for 1957, without taking the restoration into account, is \$365, based on a taxable income of \$5,000. The decrease in tax for 1954 is computed as follows:

Tax shown on return for 1954		\$ 2,000
Taxable income for 1954 upon which tax shown on return was based		35,000
Less: Additional deduction (on account of which credit or refund could be made)		5,000
		<hr/>
Total		30,000
Tax on \$30,000 (adjusted taxable income for 1954)		1,715
		<hr/> <hr/> <hr/>
Taxable income for 1954, as adjusted	\$30,000	
Less exclusion of amount restored	10,000	
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Taxable income for 1954 by applying subpart 2, item B	20,000	
Tax on \$20,000		1,145
		<hr/>
Decrease in tax for 1954 by applying subpart 2, item B		570
Tax for 1957 without taking the restoration into account		365
Amount by which decrease exceeds the tax for 1957 computed without taking restoration into account		205

The \$205 is treated as having been paid on the last day prescribed by law for the payment of the tax for 1957 and is available as a refund. In addition the taxpayer has made an overpayment of \$285 (\$2,000 less \$1,715) for 1954 because of the additional deduction of \$5,000.

Example 2. Assume the same facts as in example 1 except that, instead of the corporation being entitled to an additional deduction of \$5,000 for 1954, it is determined that the corporation failed to include an item of \$5,000 in gross income for that year. The decrease in tax for 1954 is computed as follows:

Tax shown on return for 1954		\$ 2,000
		=====
Taxable income for 1954 upon which tax shown on return was based		35,000
Plus: Additional income (on account of which deficiency assessment could be made)		5,000

Total		40,000
Tax on \$40,000 (adjusted taxable income for 1954)		2,285
		=====
Tax on \$40,000 (adjusted taxable income for 1954)		2,285
Taxable income for 1954 as adjusted	\$40,000	
Less exclusion of amount restored	10,000	
Taxable income for 1954 by applying subpart 2, item B	30,000	
Tax on \$30,000		1,715

Decrease in tax for 1954 by applying subpart 2, item B		570
Tax for 1957 without taking the restoration into account		365

Amount by which decrease exceeds the tax for 1957 computed without taking the restoration into account		205

The \$205 is treated as having been paid on the last day prescribed by law for the payment of the tax for 1957 and is available as a refund. In addition the taxpayer has a deficiency of \$285 (\$2,285 less \$2,000) for 1954 because of the additional income of \$5,000.

Subp. 5. **Method of accounting.** The provisions of Minnesota Statutes, section 290.07, subdivision 4 and this part shall be applicable in the case of a taxpayer on the cash receipts and disbursements method of accounting only to the taxable year in which the item of income included in a prior year (or years) under a claim of right is actually repaid. However, in the case of a taxpayer on the cash receipts and disbursements method of accounting who constructively received an item of income under a claim of right and included such item of income in gross income in a prior year (or years), the provisions of Minnesota Statutes, section 290.07, subdivision 4 and this part shall be applicable to the taxable year in which the taxpayer is required to relinquish the right to receive such item of income. Such provisions shall be applicable in the case of other taxpayers only to the taxable year which is the proper taxable year (under the method of accounting used by the taxpayer in computing taxable income) for taking into account the deduction resulting from the

restoration of the item of income included in a prior year (or years) under a claim of right. For example, if the taxpayer is on an accrual method of accounting, the provisions of this section shall apply to the year in which the obligation properly accrues for the repayment of the item included under a claim of right.

Subp. 6. **Inventory items, stock in trade, and property held primarily for sale in the ordinary course of trade or business.** Except for amounts specified in the following paragraph, the provisions of Minnesota Statutes, section 290.07, subdivision 4 and this part do not apply to deductions attributable to items which were included in gross income by reason of the sale or other disposition of stock in trade of the taxpayer (or other property of a kind which would properly have been included in the inventory of the taxpayer if on hand at the close of the prior taxable year) or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. This part is, therefore, not applicable to sales returns and allowances and similar items.

The provisions of Minnesota Statutes, section 290.07, subdivision 4 and this part apply to deductions which arise out of refunds or repayments made by a regulated public utility, as defined in the Internal Revenue Code of 1954, section 1503 (c)(1) or (3) and the Federal Tax Regulations, section 1.1502-2 (g), if such refunds or repayments are required to be made by the government, political subdivision, agency, or instrumentality referred to in such regulation. Thus, deductions attributable to refunds of charges for the sale of natural gas under rates approved temporarily by a proper governmental authority are eligible for the benefits of Minnesota Statutes, section 290.07, subdivision 4 and this part, if such refunds are required by the governmental authority.

Subp. 7. **Bad debts.** The provisions of Minnesota Statutes, section 290.07, subdivision 4 and this part do not apply to deductions attributable to bad debts.

Subp. 8. **Legal fees and other expenses.** Minnesota Statutes, section 290.07, subdivision 4 and this part do not apply to legal fees or other expenses incurred by a taxpayer in contesting the restoration of an item previously included in income. This rule may be illustrated by the following example:

A sold A's personal residence to B in a prior taxable year and realized a capital gain on the sale. C claimed that under an agreement with A, C was entitled to a five percent share of the purchase price since C brought the parties together and was instrumental in closing the sale. A rejected C's demand and included the entire amount of the capital gain in gross income for the year of sale. C instituted action and in the taxable year judgment is rendered against A who pays C the amount involved. In addition, A pays legal fees in the taxable year which were incurred in the defense of the action. Minnesota Statutes, section 290.07, subdivision 4 applies to the payment of the five percent share of the purchase price to C. However, the payment of the legal fees, whether or not otherwise deductible, does not constitute an item restored for purposes of Minnesota Statutes, section 290.07, subdivision 4.

Subp. 9. **Refunds.** If the decrease in tax for the prior taxable year (or years) determined under Minnesota Statutes, section 290.07, subdivision 4, and subpart 2, item B, exceeds the tax imposed by Minnesota Statutes, chapter 290 for the taxable year computed without the deduction, the excess shall be considered to be a payment of tax for the taxable year of the deduction. Such payment is deemed to have been made on the last day prescribed by law for the payment of tax for the taxable year and shall be refunded or credited in the same manner as if it were an overpayment of tax for such taxable year.

Statutory Authority: *MS s 270C.06; 290.52*

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