



Individual Income Tax--Computation of Tax Where Taxpayer Restores Substantial Amount Held Under Claim of Right. THE FEDERAL INCOME TAX COMPUTED UNDER SECTION 1341 OF THE INTERNAL REVENUE CODE FOR INDIVIDUAL INCOME TAX WILL BE EMPLOYED FOR NEBRASKA PURPOSES IF USED FOR FEDERAL PURPOSES.

Advice has been requested whether the amount of federal income tax calculated under code section 1341 of Internal Revenue Code, computation of tax where taxpayer restores a substantial amount held under claim of right, is the amount of tax to be calculated for Nebraska individual income tax purposes.

Section 77-2715(1) of the Nebraska Revised Statutes, in part, states the following:

A tax is hereby imposed for each taxable year on the entire income of every resident individual of this state and on the income of every nonresident individual of this state which is derived from sources within this state. The tax shall be a flat percentage of, for each resident individual, the taxpayer's adjusted federal income tax liability for the taxable year and, for each nonresident individual, the taxpayer's adjusted federal income tax liability for the taxable year which is attributable to income derived from sources within this state.

The taxpayer's adjusted federal income tax liability shall be the amount of federal income tax, as determined under Subtitle A, Chapter 1, subchapter A, Parts I, V, and VI of the Internal Revenue Code, for which the taxpayer would have been liable if such taxpayer had paid federal income tax based on federal taxable income as adjusted by the modifications provided in section 77-2716 without any allowance for credits against such tax permitted under the Internal Revenue Code.

Code section 5(b) of the Internal Revenue Code is a section within Subtitle A, Chapter 1, Subchapter A, Part I of the Internal Revenue Code. This section indicates that where the taxpayer restores a substantial amount held under the claim of right the federal tax liability shall be computed under the provisions of code section 1341.

Payments received under a claim of right must be included in gross income. This is true even though it is established at a later time that the taxpayer did not have an unrestricted right to the payments and

must repay the same amount. A taxpayer is allowed to deduct the repayments in the year in which the repayments are made. However, the deduction may not adequately compensate for the tax paid in the earlier year. This inequity is eliminated if the amount repaid exceeds \$3,000. In such case, under Code section 1341(a)(5), the taxpayer may decrease his tax for the year of repayment. The amount of tax for the year of repayment will be the tax for the taxable year computed without deduction minus the decrease in tax for the prior taxable year which would result from the exclusion of such item(s) from gross income for the prior taxable year. However, under Code section 1341(a)(4), if a lesser tax liability results by the taxpayer simply deducting the repaid amount in the year of repayment, the taxpayer is to claim the deduction instead. In either instance, the adjustment is made for the year of repayment.

The method of calculating the federal tax liability under either Code section 1341(a)(4) or Code section 1341(a)(5) on the federal return filed with the Internal Revenue Service is to be used for the Nebraska individual income tax return. If adjustments for Nebraska purposes are made to federal taxable income, such as the deduction for U.S. government interest income, the federal taxable income after Nebraska adjustments is to be used in the section 1341 computation for Nebraska. A copy of the federal return and schedules of claim of right computations must be attached to the Nebraska return, including any recomputations required by Nebraska adjustments.

Nebraska tax will be computed as follows:

- (1) If federal tax liability has been calculated under Code section 1341(a)(4) (computed with the deduction), the amount of federal income tax liability for the taxable year shall be entered on the line of the Nebraska individual income tax return that indicates federal tax before credits. Write on this line "section 1341 Claim of Right--see attached schedules." Add any alternative minimum tax as recomputed for Nebraska purposes, if applicable, to this amount. This tax amount will be multiplied by the current Nebraska income tax rate which is the rate in the year in which repayment is made.
- (2) If federal tax liability has been calculated under Code section 1341(a)(5) (computed without the deduction minus the decrease in federal tax for the prior year resulting solely from the exclusion of the payments from gross income for the prior year), and if the decrease in federal tax is equal to or less than the federal tax imposed for the taxable year computed without deduction, then the amount of federal tax liability as computed will be entered on the line of the Nebraska Individual Income Tax Return that indicates federal tax before credits. Write on this line "section 1341 Claim of Right--see attached schedules." Add any alternative minimum tax as recomputed for Nebraska purposes, if applicable, to this amount. This tax will be multiplied by the current Nebraska

income tax rate which is the rate for the year in which repayment is made.

If the decrease in federal tax exceeds the federal tax imposed for the taxable year (computed without deduction), the amount of such excess (reduced after adding any alternative minimum tax as recomputed for Nebraska purposes, if applicable) shall be considered an overpayment of tax on the last day prescribed by law for the payment of tax for the year of repayment. The amount of such overpayment shall be multiplied by the current Nebraska income tax rate which is the rate for the year of repayment to determine the amount of Nebraska overpayment. This amount of Nebraska overpayment will be added to the total credits line of the Nebraska individual income tax return. Write on this line "section 1341 Claim of Right--see attached schedules."

Where the calculation results in a net operating loss or capital loss, the special rules in Code section 1341(b) governing such losses shall be followed for Nebraska tax purposes.

APPROVED:



Donna Karnes  
State Tax Commissioner

May 3rd, 1985