Tax Reduction Letter

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Internal Revenue Manual Section 5.8.5.15 (09-30-2013)

Income-Producing Assets

1. When investigating the RCP for an offer that includes business assets, an analysis is necessary to determine if certain assets are essential for the production of income. When it has been identified that an asset or a portion of an asset is necessary for the production of income, it is appropriate to adjust the income or expense calculation for that taxpayer to account for the loss of income stream if the asset was either liquidated or used as collateral to secure a loan to fund the offer.

2. When valuing income-producing assets:

If…	Then…
There is no equity in the assets	There is no adjustment necessary to the income stream.
There is equity and no available income stream (i.e. profit) produced by those assets	There is no adjustment necessary to the income stream. Consider including the equity in the asset in the RCP.
There are both equity in assets that are determined to be necessary for the production of income and an available income stream produced by those assets	• Compare the value of the income stream produced by the income producing asset(s) to the equity that is available. • Determine if an adjustment to income or expenses is appropriate.
An asset used in the production of income will be liquidated to help fund an offer	Adjusting the income to account for the loss of the asset may be appropriate.
A taxpayer borrows against an asset that is necessary for the production of income, and devotes the proceeds to the payment of the offer	Allow the loan payment as an expense and consider the effect that loan will have on the future income stream.

3. As a general rule, equity in income producing assets will not be added to the RCP of a viable, ongoing business; unless it is determined the assets are not critical to business operations.

   Exception:
   Equity in real property should be included in calculation of RCP.

   Note:
   Even though rental property may produce income for the taxpayer, the equity should be included in RCP. An adjustment to the taxpayer's future income value may be appropriate, if the taxpayer will be borrowing against or selling the property to fund the offer.

   The following examples provide some guidance in evaluating equity and income produced by assets:

Example:
(1) A business depends on a machine to manufacture parts and cannot operate without this machine. The equity is $100,000. The machine produces net income of $5,000 monthly. The RCP should include the income produced by the machine, but not the equity. Equity in this machine will generally not be included in the RCP because the machine is needed to produce the income, and is essential to the ability of the business to continue to operate.

Note:
It is in the government's best interests to work with this taxpayer to maintain business operations, particularly in a bad economy.

Example:
(2) The same business in the prior example, but the business can continue to operate without the machine, i.e. the equipment is not used in the process of generating the key product of the business. The machine generates only $500 net monthly income. Consider including the equity in the RCP and remove $500 from the business income

Example:
(3) A trucking company has ten trucks. Eight are fully encumbered and two trucks have no encumbrances and $30,000 in equity. The two trucks combined generate net income of $12,000 per year. The net income from the trucks is included in the calculation of Future Income Value. The equity in the trucks should not be included in RCP.

Example:
(4) The same trucks described in the previous example generate only $1000 per year in net income, but have $30,000 in equity. If the business can successfully operate without the two trucks, consider removing the income from the RCP and including the equity in the RCP.

Example:
(5) A BMF in-business taxpayer owns real property with net equity of $50,000. The equity in the real property should be included in RCP, yet the taxpayer's net income should be adjusted for the loss of any rent/lease payments, or required loan payments.

Example:
(6). The property discussed in example (6) is leased and the taxpayer will borrow $40,000 against the equity to fund the offer. The property generates $1,500 of net income each month and the loan will require payments of $1,000 per month. In this instance, the OE/OS will include in the calculation of RCP, the $50,000 equity in the real property, plus the remaining $500 (after allowing for the loan repayment) per month for the number of months based on the terms of the offer.

4. Based on the taxpayer's specific circumstances, there may instances where the income producing assets in a Subchapter S corporation may be treated similar to assets owned by a taxpayer's sole proprietorship business.

   Factors to consider include:

   - Type of business activity
   - Taxpayer's occupation

- Current income received from the corporation as salary and the amount of future income that the taxpayer will receive
- Current income received from corporation as dividend
- Ability of the taxpayer to sell their interest in the corporation.

Example:
A taxpayer operates a construction company, as a Sub S corporation, in which his wages from the corporation are $ 60,000 per year. The taxpayer's future income value of $12,000 is based on net income of $1000 per month for 12 months (cash offer). The taxpayer's interest in the corporate assets is equal to $20,000. It is determined all assets are required for the production of income by the corporation. Since the taxpayer shows a net income from the business, the exclusion of income producing assets may be appropriate in this instance.

Example:
The same scenario as the previous example, yet the taxpayer does not draw a salary and the corporation shows a loss from the Sub S. Since the corporation is not generating any income for the taxpayer, the taxpayer's interest in the corporation should be included in RCP.

5. When considering equity in income producing assets and the effect on income streams and expenses, you must exercise sound judgment consistent with the unique facts of each case.
6. Each case must be thoroughly documented regarding equity decisions in income producing property