§ 7.48–3 Election to apply the amendments made by sections 804 (a) and (b) of the Tax Reform Act of 1976 to property described in section 50(a) of the Code.

(a) *General rule.* Under section 804(e)(2) of the Tax Reform Act of 1976 (90 Stat. 1596), taxpayers may elect to apply the amendments made by section 804 (a) and (b) of the Act to movie and television films that are property described in section 50(a) of the Code and that were placed in service in taxable years beginning before January 1, 1975.

(b) *Time for and manner of making election*—(1) *Time for making election.* The election under section 804(e)(2) the Act must be made not later than October 4, 1977.

(2) *Manner of making election.* The election under section 804(e)(2) shall be made by applying the same rules applicable under section 804(c)(2) as described in § 7.48–2(b) (2), (3), and (4) except that § 7.48–2(b)(2)(ii) shall be read to require a statement that the taxpayer is making an election under section 804(e)(2) of the Act, and § 7.48–2(b)(2)(vi) shall not apply. An election properly made under section 804(e)(2) of the Act may not be revoked after October 4, 1977.

(Sec. 804(e)(2), Tax Reform Act of 1976 (90 Stat. 1596))

[T.D. 7509, 42 FR 47828, Sept. 22, 1977]

§ 7.57(d)–1 Election with respect to straight line recovery of intangibles.

(a) *Purpose.* This section prescribes rules for making the election permitted under section 57(d)(2), as added by the Tax Reform Act of 1976. Under this election taxpayers may use cost depletion to compute straight line recovery of intangibles.

(b) *Election.* The election under section 57(d) is subject to the following rules:

(1) The election is made within the time prescribed by law (including extensions thereof) for filing the return for the taxable year in which the intangible drilling costs are paid or incurred or, if later, by July 25, 1978.

(2) The election is made separately for each well. Thus, a taxpayer may make the election for only some of his or her wells.

(3) The election is made by using, for the well or wells to which the election applies, cost depletion to compute straight line recovery of intangibles for purposes of determining the amount of the preference under section 57(a)(11).

(4) The election may be made whether or not the taxpayer uses cost depletion in computing taxable income.

(5) The election is made by a partnership rather than by each partner.

(c) *Computation of cost depletion.* For purposes of computing straight line recovery of intangibles through cost depletion, both depletable and depreciable intangible drilling and development costs for the taxable year are taken into account. They are treated as if capitalized, added to basis, and recovered under § 1.611–2(a). Costs paid or incurred in other taxable years are not taken into account.

(Secs. 57(d) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1551; 68A Stat. 917; 26 U.S.C. 57(d), 7805))

[T.D. 7541, 43 FR 17816, Apr. 26, 1978; 43 FR 18993, May 3, 1978]

§ 7.105–1 Questions and answers relating to exclusions of certain disability income payments.

The following questions and answers relate to the exclusion of certain disability income payments under section 105(d) of the Internal Revenue Code of 1954, as amended by sections 505 (a) and (c) of the Tax Reform Act of 1976 (90 Stat. 1566):

Q–1: *What effect on the sick pay exclusion does the new law have?*

A–1: The ''sick pay'' provisions of prior law (which allowed a limited exclusion from gross income of sick pay received before mandatory retirement age by active employees temporarily absent from work because of sickness or injury, as well as by disability retirees) have been replaced by provisions of the new law (which provide for a limited exclusion of disability payments but restrict its application to individuals retired on disability who meet certain requirements as to permanent and total disability, age, etc.) (Q–4). As a result of the more restrictive provisions of the new law, many taxpayers who qualified for the exclusion in previous taxable years will not be eligible to claim the disability payments exclusion beginning with the effective date of the new law.

Q–2: *What is the effective date of the new law relating to disability exclusion?*

A–2: The disability income exclusion and related annuity provisions of the Tax Reform Act of 1976 are effective for taxable years beginning on or after January 1, 1977. In addition, the Tax Reduction and Simplification Act of 1977 allows certain taxpayers to begin excluding pension or annuity costs in taxable years beginning in 1976. In the case of a retiree who uses the cash receipts and disbursements method of accounting, the new law applies to payments received on or after the effective date even if the payment is for a period before the effective date. Thus, a payment for December 1976 that is received in January 1977 by a calendar-year, cash-basis taxpayer is controlled by the new law.

Q–3: *What are disability payments?*

A–3: In general, disability payments are amounts constituting wages or payments in lieu of wages made under provisions of a plan providing for the payment of such amounts to an employee for a period during which the employee is absent from work on account of permanent and total disability. Amounts paid to such an employee after mandatory retirement age is attained are not wages or payments in lieu of wages for purposes of the disability income exclusion.

Q–4: *Who is eligible to exclude disability payments?*

A–4: A taxpayer who receives disability payments in lieu of wages under a plan providing for the payment of such amounts may qualify for the exclusion provided all of the following requirements are met:

(1) The taxpayer has not reached age 65 (see Q–9) before the end of the taxable year;

(2) The taxpayer has not reached mandatory retirement age (see Q–8) before the beginning of the taxable year;

(3) The taxpayer retired on disability (see Q–10) (or if retired prior to January 1, 1977 and did not retire on disability, would have been eligible to retire on disability at the time of such retirement);

(4) The taxpayer was permanently and totally disabled (see Q–11) when the taxpayer retired (or if the taxpayer retired before January 1, 1977, was permanently and totally disabled on January 1, 1976, or January 1, 1977); and

(5) The taxpayer has not made an irrevocable election not to claim the disability income exclusion (see Q–17 through Q–19).

Q–5: *What limitations are placed on the amounts excludable?*

A–5: The amount of disability income that is excludable:

(a) Cannot exceed the amount of the disability income payments received for any pay period;

(b) Cannot exceed a maximum weekly rate of $100 per taxpayer. Thus, the maximum disability income exclusion allowable on a joint return (see Q–7) in the usual case where one spouse receives disability payments, generally, would be $5,200, and if both spouses received disability payments the maximum exclusion, generally, would be $10,400 ($5,200 for each spouse);

(c) Cannot exceed, in the case of a disability income payment for a period of less than a week, a prorated portion of the amount otherwise excludable for that week (see Q–6); and

(d) Cannot exceed, for the entire taxable year, the total amount otherwise excludable for such taxable year reduced, dollar for dollar, by the amount by which the taxpayer's adjusted gross income (determined without regard to the disability income exclusion) exceeds $15,000. Where a disability income exclusion is claimed by either or both spouses on a joint return, the taxpayer's adjusted gross income means the total adjusted gross income of both spouses combined (determined without regard to the disability income exclusion) (see also Q–7).

Q–6: *On what occasion is a taxpayer likely to receive part-week disability payments? How do you prorate such payments?*

A–6: Such part-week payments may be received when one of the following events occurs after the first day of the taxpayer's normal workweek: (a) the disability retirement commences: (b) the taxpayer reaches mandatory retirement age in a taxable year prior to the taxable year in which such taxpayer attains age 65; or (c) the taxpayer dies. To prorate a part-week disability income payment for purposes of the exclusion, the taxpayer must:

(1) Determine the ''daily exclusion,'' which is the lesser of—

(a) The taxpayer's daily rate of disability pay, or

(b) $100 divided by the number of days in the taxpayer's normal workweek.

(2) Multiply the daily exclusion by the number of days for which the part-week payment was made.

Thus, for a taxpayer whose normal workweek was Monday through Friday and whose retirement on permanent and total disability began on Wednesday, the first disability income payment would include a payment for a part-week consisting of three days. Assuming that the daily exclusion determined in (1), above, is $20, the taxpayer's exclusion for the first week would be $60 ($20×3).

Q–7: *What filing restrictions apply to a married taxpayer who claims a disability income exclusion?*

A–7: A taxpayer married at the close of the taxable year who lived with his or her spouse at any time during such taxable year must file a joint return in order to claim the disability income exclusion. However, a taxpayer married at the close of the taxable year who lived apart from his or her spouse for the entire taxable year may claim the exclusion on either a joint or separate return.

Q–8: *What is ''mandatory retirement age''?*

A–8: Generally, mandatory retirement age is the age at which the taxpayer would have been required to retire under the employer's retirement program, had the taxpayer not become disabled.

Q–9: *Does a taxpayer reach age 65 on the day before his or her 65th birthday for purposes of the disability income exclusion, as is the case for purposes of the exemption for age and the credit for the elderly?*

A–9: No. For purposes of the disability income exclusion, a taxpayer reaches age 65 on the day of his or her 65th birthday anniversary. Thus, a taxpayer whose 65th birthday occurs on January 1, 1978, is not considered to reach age 65 during 1977, for purposes of the disability income exclusion.

Q–10: *What does ''retired on disability'' mean?*

A–10: Generally, it means that an employee has ceased active employment in all respects because of a disability and has retired under a disability provision of a plan for employees. However, an employee who has actually ceased active employment in all respects because of a disability may be treated as ''retired on disability'' even though the employee has not yet gone through formal ''retirement'' procedures, as for example, where an employer carries the disabled employee in a non-retired status under the disability provisions of the plan solely for the purpose of continuing such employee's eligibility for certain employer-provided fringe benefits. In addition, such an employee may be treated as ''retired on disability'' even though the initial period immediately following his or her ceasing of employment on account of a disability must first be used against accumulated ''sick leave'' or ''annual leave'' prior to the employee being formally placed in disability retirement status.

Q–11: *What is permanent and total disability?*

A–11: It is the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that:

(a) Can be expected to result in death;

(b) Has lasted for a continuous period of not less than 12 months; or

(c) Can be expected to last for a continuous period of not less than 12 months. The substantial gainful activity referred to is not limited to the activity, or a comparable activity, in which the individual customarily engaged prior to such individual's retirement on disability.

See §7.105–2 for additional information relating to substantial gainful activity.

Q–12: *If a taxpayer retired on disability but it is not clear until the following taxable year that the disability as of the date of such retirement was permanent and total (so that the employee did not exclude any amount as disability income in the earlier taxable year), may the taxpayer file an amended return to claim the disability income exclusion for the taxable year in which such taxpayer retired on disability which was permanent and total?*

A–12: Yes.

Q–13: *What proof must a taxpayer furnish to establish the existence of permanent and total disability?*

A–13: If retired on disability before January 1, 1977: A certificate from a qualified physician attesting that—

(a) The taxpayer was permanently and totally disabled on January 1, 1976 or January 1, 1977; or

(b) The records of the Veterans Administration show that the taxpayer was permanently and totally disabled as defined in 38 CFR 3.340 or 3.342 on January 1, 1976 or January 1, 1977.

If retired on disability during 1977 or thereafter: A certificate from a qualified physician attesting that—

(a) The taxpayer was permanently and totally disabled on the date he or she retired; or

(b) The records of the Veterans Administration show that the taxpayer was permanently and totally disabled as defined in 38 CFR 3.340 or 3.342 on the date he or she retired.

In either case, the taxpayer must attach the certificate or a copy of the certificate to his or her income tax return. The certificate shall give the physician's name and address. No certificate from any employer is required with regard to the determination of permanent and total disability.

Q–14: *For what period does a taxpayer eligible (see Q–4) for the disability income exclusion (without regard to the $15,000 income phaseout explained in Q–5) continue to be eligible for such exclusion?*

A–14: Unless the taxpayer earlier makes the irrevocable election not to claim the disability income exclusion described in Q–17 through Q–19, such taxpayer continues to be eligible until the earlier of:

(a) The beginning of the taxable year in which the taxpayer reaches age 65; and

(b) The day on which the taxpayer reaches mandatory retirement age.

Q–15: *May a taxpayer while eligible (see Q–4) for the disability income exclusion under the new law, exclude any applicable pension or annuity costs?*

A–15: No. This is true even though while eligible for the disability income exclusion, such taxpayer is unable to exclude any amount of the disability income payments because of the $15,000 income phaseout (see Q–5).

Q–16: *When will a taxpayer who is eligible (see Q–4) to exclude disability income payments (without regard to the $15,000 phaseout explained in Q–5) under the new law be able to exclude any applicable pension or annuity costs?*

A–16: In general, such a taxpayer will begin to exclude any of his or her pension or annuity costs under applicable rules of the Code beginning on the first day of the taxable year in which he or she attains age 65 or, if mandatory retirement age is attained in an earlier taxable year, beginning on the day the taxpayer attains mandatory retirement age.

Q–17: *May a taxpayer who is eligible (see Q–4) to exclude disability income payments (without regard to the $15,000 phaseout explained in Q–5) under the new law begin to exclude applicable pension or annuity costs in an earlier taxable year?*

A–17: Yes, but such a taxpayer must make the election described in Q–18 and Q–19 in which case the taxpayer would no longer be eligible for the disability income exclusion.

Q–18: *What is an election not to claim the disability income exclusion?*

A–18: It is an irrevocable election for the taxable year for which the election is made, and each taxable year thereafter. If such an election is made the taxpayer will begin to recover tax-free, out of the payments, his or her annuity costs as provided under the applicable provision of the Code.

Q–19: *How does a taxpayer who is eligible to exclude disability income payments (without regard to the $15,000 phaseout explained in Q–5) under the new law make this election?*

A–19: The election is made by means of a statement attached to the taxpayer's income tax return (or amended return) for the taxable year in which the taxpayer wishes to have the applicable annuity rule apply. The statement shall set forth the taxpayers qualifications to make the election (i.e., that the taxpayer is eligible (see Q–4) to exclude disability income payments (without regard to the $15,000 income phaseout explained in Q–5)) and that such taxpayer irrevocably elects not to claim the benefit of excluding disability income payments under section 105(d), as amended, for such taxable year and each taxable year thereafter. The election cannot be made for any taxable year beginning before January 1, 1976.

Q–20: *Did the changes made by the Tax Reduction and Simplification Act provide any relief to taxpayers eligible for the sick pay exclusion in taxable years beginning in 1976?*

A–20: Yes. As originally enacted, the more restrictive provisions of the disability income exclusion applied to taxable years beginning in 1976. The Tax Reduction and Simplification Act postponed the effective date of these provisions for 1 year. Thus, taxpayers may claim the sick pay exclusion in taxable years beginning in 1976.

(Secs. 105(d) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1566; 68A Stat. 917; 26 U.S.C. 105(d); 7805))

[T.D. 7450, 41 FR 56630, Dec. 29, 1976, as amended at 42 FR 2954, Jan. 14, 1977; T.D. 7544, 43 FR 19655, May 8, 1978]

§ 7.105–2 Substantial gainful activity.

(a) *Purpose.* This section defines substantial gainful activity for purposes of section 105(d) and § 7.105–1, prescribes rules for determining whether a taxpayer has the ability to engage in substantial gainful activity, and provides examples of the application of the definition and rules in specific factual situations.

(b) *Definition.* Substantial gainful activity is the performance of significant duties over a reasonable period of time in work for remuneration or profit (or in work of a type generally performed for remuneration or profit).

(c) *General rules.* (1) Full-time work under competitive circumstances generally indicates ability to engage in substantial gainful activity.

(2) Work performed in self-care or the taxpayer's own household tasks, and nonremunerative work performed in connection with hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities is not substantial gainful activity. However, the nature of the work performed may be evidence of ability to engage in substantial gainful activity.

(3) The fact that a taxpayer is unemployed for any length of time is not, of itself, conclusive evidence of inability to engage in substantial gainful activity.

(4) Regular performance of duties by a taxpayer in a full-time, competitive work situation at a rate of pay at or above the minimum wage will conclusively establish the taxpayer's ability to engage in substantial gainful activity. For purposes of paragraphs (c)(4) and (c)(5) of this section, the minimum wage is the minimum wage prescribed by section 6(a)(1) of the Fair Labor Standards Act of 1938, as amended, 29 U.S.C. 206(a)(1).

(5) Regular performance of duties by a taxpayer in a part-time, competitive work situation at a rate of pay at or above the minimum wage will conclusively establish the taxpayer's ability to engage in substantial gainful activity, if the duties are performed at the employer's convenience.

(6) In situations other than those described in paragraphs (c)(4) and (c)(5) of this section, other factors, such as the