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IRC §267 EXPLAINED: MATCHING, LOSS DISALLOWANCE, AND CONSTRUCTIVE OWNERSHIP

Presented by:

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Victoria Boon is a seasoned tax consultant and nationally recognized expert in federal taxation, with more than 20 years of experience in audit strategy, IRS compliance, and professional education. A former IRS Senior Revenue Agent and Subject Matter Expert with the Internal Revenue Service, Victoria brings deep technical knowledge and real-world insight to her consulting and training work in the private sector.

Throughout her career, Victoria has specialized in complex areas of the tax code, including IRC §§ 1031, 162, 274, and conservation easements. She has led large corporate audits, developed continuing education programs for IRS staff and tax professionals, and contributed to key IRS publications such as Publications 544, 551, and 946. Victoria also served as a campaign expert on aircraft taxation and conservation easements, shaping national audit priorities and training curricula.

Now in private practice, Victoria offers consulting services, CE instruction, and expert guidance on audit defense, tax law interpretation, and IRS procedure for practitioners, firms, and financial advisors across the country.

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Course Objectives

At the end of this course, participants will be able to:

- Describe the purpose and scope of IRC § 267 and why related party rules exist.
- Identify the types of relationships and ownership structures that trigger § 267 restrictions.
- Apply the matching rules to income and deductions, including special rules for S corporations, partnerships, and pass-through entities.
- Analyze constructive ownership provisions and explain how attribution rules affect taxpayers.
- Evaluate common compliance flags and IRS adjustments in related party transactions (interest, rent, accrued wages, etc.).
- Recognize how § 267 interacts with other Code sections such as §§ 170, 274, 318, 453, 1031, and 1239.

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Overview

- IRC § 267

- Matching methods of accounting
  - Expenses
  - Interest
  - Payments to Foreign Persons

- Relationships

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IRC § 267(a)(1)

- Generally, no deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b)

Note: This does not apply to any loss of the distributing corporation (or the distrubutee) in the case of a distribution in complete liquidation.

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IRC § 267(a)(2)

- Matching of deduction and payee income item in the case of expenses and interest
  - (A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible In the gross income of such person. and
  - (B) at the close of the taxable year of the taxpayer for which (but for this paragraph) the amount would be deductible under this chapter, both the taxpayer and the person to whom the payment is to be made are persons specified in any of the paragraphs or subsection (b). then any deduction allowable under this chapter in respect of such amount shall be allowable as of the day as of which such amount is includible in the gross income of the person to whom the payment is made

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Most Common IRC § 267 Adjustments

- Interest on Related Party Loans
  - No interest charged or income recorded on individual returns
  - Example:
    - IRS Reviewed in detailed liability and shareholder loans
    - Find no Interest charged on the loan
    - IRS can, and often will, assess accrued interest and dividends can be assessed if loans are to shareholder

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Original Issue Discount (OID) Example

- Question - Does IRC § 267(a)(2) ever apply to defer the deduction of otherwise deductible original issue discount (OID) as defined in IRC § 163(e) and IRC §§ 1271 through 1275?

- Answer-
  - No. Regardless of when payment is made, an amount owed to a lender that is considered original issue discount is included in the lender's income in accordance with the OID rules.

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IRC § 267(a)(2) Example

- Does IRC § 267(a)(2) ever apply to defer the deduction of an otherwise deductible amount if the person to whom the payment will be made properly uses the completed contract method with respect to such amount?
- No. IRC § 267(a)(2) applies only if an otherwise deductible amount is owed to a related person whose method of accounting is such that the amount is not includible in income unless paid to such person.
- Regardless of when payment is made, an amount owed to a contractor using the completed contract method is includible in the income of the contractor per Treas. Reg.§ 1.451-3(d) in the year in which the contract is completed.

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IRC § 267(b) Relationships

1. Family Members
2. And individual and a corporation. if the individual owns more than 50% in value of the outstanding stock
3. Two corporations that are members of the same controlled group
4. A grantor and fiduciary of any trust
5. A fiduciary of a trust and a fiduciary of another trust. if the same person is granter of both trusts
6. A fiduciary of a trust and a beneficiary of such trust
7. A fiduciary of a trust and a beneficiary of another trust. if the same person is a grantor of both trusts

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IRC § 267(b) Relationships cont.

8. A fiduciary of a trust and a corporation, if trust or granter owns more than 50% of the value of outstanding stock
9. A person and an IRC § 501 (tax exempt) organization controlled by such person or members of person's family
10. A corporation and a partnership if the same person owns: More than 50% of the value of outstanding stock, and more than 50% of the capital or profits interest in the partnership
11. An S corp. and another S corp. if the same persons own more than 50% in value of outstanding stock of each corporation
12. An S corp. and a C corp., if the same persons own more than 50% in value of outstanding stock of each corporation
13. An executor of an estate and the beneficiary of such estate

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Constructive Ownership of Stock

1. Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;
2. An individual shall be considered as owning the stock owned. directly or indirectly, by or for his family;
3. An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;
4. The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants

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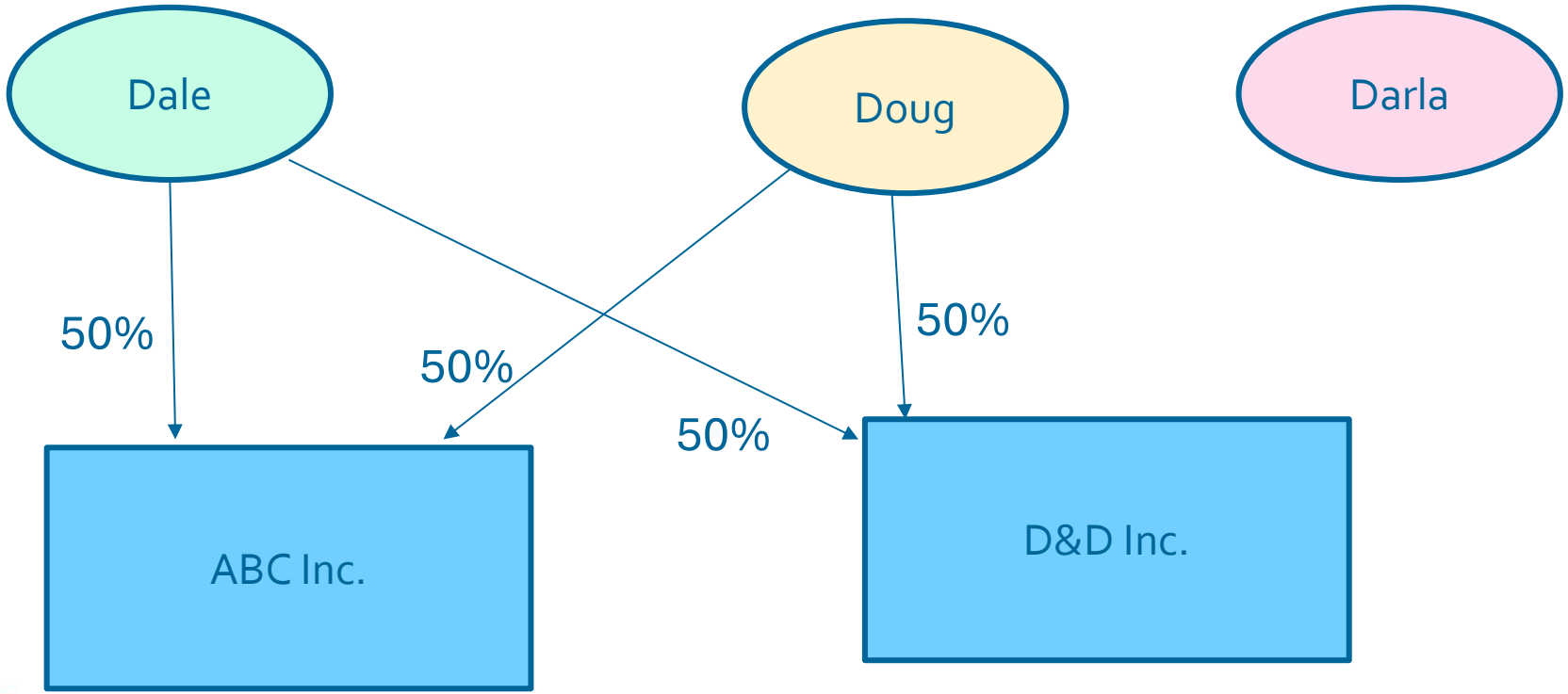
Constructive Ownership Example



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Constructive Ownership Example cont.

Constructive Ownership for ABC Inc. and D&D Inc.

	Direct	Constructive	Total
Dale	50%	50%	100%
Doug	50%	50%	100%
Darla	0%	50%	50%

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Special Rules - Pass-thru Entities

IRC § 267(e)(1):

- (B) in the case of
  - (i) a partnership, any person who owns (directly or indirectly) any capital interest or profits interest of such partnership, or
  - (ii) an S corporation, any person who owns (directly or indirectly) any of the stock of such corporation.
- (C) any person who owns (directly or indirectly) any capital interest or profits interest of a partnership in which such entity owns (directly or indirectly) any capital interest or profits interest, and
- (D) any person related to a person described in subparagraph (B) or (C), shall be treated as persons specified in a paragraph of subsection (b).

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S Corp. Example

- An accrual basis S Corporation may not deduct an accrued expense payable to a cash basis shareholder until the amount is included in income by the shareholder.

  - The rule for matching payments between related parties applies to both C corporations and S corporations, but the definition of a related party is broader in the context of S corporations. For a C corporation. a shareholder is only considered a related party if the shareholder owns more than 50% of the C corporation's stock, while every S corporation shareholder is considered a related party under IRC § 267(e). This results in no deduction being allowed for an accrual of an expense between an accrual method S corporation and any of its shareholders if the shareholder is on the cash basis method of accounting and has not yet reported the income, even if all other usual requirements for deductibility have been met.

S Corp. Example -Accrued Bonus

- An accrual basis S Corporation may not deduct an accrued expense payable to a cash basis shareholder until the amount is included in income by the shareholder.

  - On its 2024 calendar year Form 1120S, an S corporation accrues a $20,000 bonus to a 10% individual shareholder. The S Corporation pays the $20,000 bonus in January 2025. Although the bonus is paid within 2 ½ months of the S corporation's year end, no deduction is allowed in 2024 because the shareholder did not include the bonus payment in gross income until tax year 2025 and the shareholder is considered a related party under IRC § 267(e).

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Compliance Flags

- In the Current Liabilities or Other Liabilities schedules, reference to an accrual to an officer/shareholder.
- There is accrued interest and the only debt is a loan from the shareholder (B/S Line 19).
- There are accrued wages or bonus expenses and it appears the only employees are shareholders.
- There are accrued rent expenses and the S corporation is renting from a shareholder

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Partnerships - Constructive Ownership

IRC § 267(e)(3): Constructive ownership in the case of partnerships

- For purposes of determining ownership of a capital interest or profits interest of a partnership, the principles of subsection (c) shall apply, except that-
  - paragraph (3) of subsection (c) shall not apply, and
  - interests owned (directly or indirectly) by or for a C corporation shall be considered as owned by or for any shareholder only if such shareholder owns (directly or indirectly) 5 percent or more in value of the stock of such corporation.

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IRC § 267(f)(2) Controlled Groups

Special Rules Applicable to Controlled Groups

❖ Deferral (rather than denial) of loss from sale or exchange between members

- In the case of any loss from the sale or exchange of property which is between members of the same controlled group and to which subsection (a)(1) applies (determined without regard to this paragraph but with regard to paragraph (3))-
  - (A) subsections (a)(1) and (d) shall not apply to such loss, but
  - (B) such loss shall be deferred until the property is transferred outside such controlled group and there would be recognition of loss under consolidated return principles or until such other time as may be prescribed in regulations

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IRC § 267 Transactions for Losses

IRC § 267(a)(1), Deduction for Losses Disallowed

- No deduction for sale or exchange of property, directly or Indirectly, between persons specified in IRC § 267(b).
- Example: John sells land to his son for $1. The land has an adjusted basis of $100. John cannot deduct the $99 loss pursuant to IRC § 267(a)(1).

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IRC § 267 Transactions for Gains

Does IRC § 267(a)(1) apply to gains?

- Only losses are disallowed. Gains are recognized.
  - Example: John sells land to his son for $200. The land has an adjusted basis of $100. John recognizes a $100 gain. I.RC.§ 267(a)(1) does not apply.

- Gains are allowed even if they offset unrelated losses.
  - Example: John sells stock in X to his son for $200. The stock has an adjusted basis of $100. John also sells stock in Yon the market for a loss of $100. John may offset the $100 gain from the sale of X to his son against the $100 loss from the sale of Y stock.

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IRC § 267 Example: Sale to related Corp.

- Example:
  - John is the sole shareholder of XYZ corp. John, as an individual, purchased land for $100,000. John sold the land to XYZ corp. in a bona fide transaction for the appraised value of $80,000.
  - IRC § 267(a)(1) disallows the $20,000 loss regardless of whether the sale is bona fide or if the sales price equals fair market value

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IRC § 267 Netting Gains and Losses

- What about netting gains against related losses?
  - Gains cannot be reduced by, or netted against, any related party losses, even when the gains and losses are recognized on a single transaction
- Example:
  - Frank was the sole shareholder of XYZ corp. Frank, as an individual, purchased lots of mixed metals. Over the next few months, Frank sold the lots of mixed metals to XYZ. Some lots were sold at a gain, and some were sold at a loss.
  - Gains are recognized. Losses are not. Frank cannot net losses and gains.
  - See Engelhart v. Commissioner, 30 T.C. 1013 (1958)

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IRC § 267(d) Gains where Losses Previously Disallowed

- If a taxpayer acquires property by purchase or exchange from a related party who realized a loss on the transaction,
- And the loss was disallowed due to the related party rules,
- Then any gain realized by the taxpayer on a subsequent sale is recognized only to the extent the gain exceeds the previously unrecognized loss
- Example: John is the sole shareholder of XYZ corp. John, as an individual, purchased land for $100,000. John sold the land to XYZ corp. in a bona fide transaction for the appraised value of $80,000. John can not recognize the loss on this, but if XYZ later sells this property for a of $50,000 gain then the gain recognized by XYZ would be $30,000 ($50,000 gain - $20,000 unrecognized loss)

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Other Code Sections

Related party rules are referred to by other code sections including:

- IRC § 170 - Charitable Contributions and Gifts;
- IRC § 274 - Disallowance of certain entertainment, etc. expenses;
- IRC § 280F - Limitation on depreciation for listed property;
- IRC § 318 - Constructive ownership of stock;
- IRC § 453 - Installment method;
- IRC § 1031 - Exchange of property held for productive use or investment;
- IRC § 1033 - Involuntary conversions: and
- IRC § 1239 - Gain from sale of depreciable property between certain related taxpayers.

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Questions?

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