

Example 14. On October 1, 1971, A, an author, and Corporation M, a publisher, executed an agreement under which A granted to M the exclusive right to print, publish and sell a book he had written. The agreement provides that M will pay to A specified royalties based on the actual cash received from the sale of the published work, render semi-annual statements of the sales, and at the time of rendering each statement make settlement for the amount due. On the same day, another agreement was signed by A and M, mutually agreeing that, in consideration of, and notwithstanding, any contrary provisions contained in the first contract, M shall not pay A more than \$100x in any one calendar year. Under this supplemental contract, sums in excess of \$100x accruing in any one calendar year are to be carried over by M into succeeding years. For the calendar year 1971, royalties payable to A under the basic agreement amount to \$100x and this sum is paid to A. For the calendar year 1972, royalties of \$120x are payable to A under the basic agreement, but by reason of the supplemental agreement, only \$100x of this sum is actually paid to A. For each of the calendar years 1973 and 1974, royalties of \$100x are payable to A under the basic agreement, and this sum is paid to A. For the calendar year 1975, royalties of \$80x are payable to A under the basic agreement, and this sum, plus \$20x carried over from 1972, or \$100x, is paid to A. The \$100x paid to A in each of the years 1971, 1972, 1973, and 1974, and \$80x of the \$100x paid to A in 1975 constitute earned income. The additional \$20x carried over from 1972 and paid to A in 1975 constitutes deferred compensation under this paragraph (b) because it was paid to A later than the end of the year following the year (i.e., 1972) in which A's right to receive the amount was not subject to a substantial risk of forfeiture.

Example 15. Corporation M is the producer and owner of a feature length motion picture which is distributed to exhibitors by Corporation N pursuant to a distribution agreement between M and N providing for current payments to M of a given percentage of the current net profits derived by N from the exhibition and exploitation of the picture. A was employed by M as the leading actor in the picture for fixed compensation payable at the rate of \$10x per week during the production period plus additional compensation equal to a given percentage of the net profits derived from the exhibition and exploitation of the picture. A's additional compensation is payable at the time that M receives payments from N under the terms of the distribution agreement. The additional compensation paid to A does not constitute deferred compensation since it is attributable to and measured by current net profits derived from the use of property created in part by A's efforts.

Example 16. A, a boxer entered into an agreement with M boxing club to fight a particular opponent on June 19, 1971. The agreement provided in part, that for his performance A was to receive 16 percent of the gross receipts derived from the match. Simultaneously, A and M executed a separate agreement providing for payment of A's share of the receipts from the match as follows: 25 percent thereof not later than August 15, 1971, and 25 percent thereof during each of the years 1972, 1973, and 1974 in equal semi-annual installments. A's share of the gross receipts derived from the match was \$100x, of which 25 percent was paid to him in 1971 and a total of \$25x in each of the years 1972, 1973, and 1974. Under the particular facts and circumstances, A and M are not acting as partners or joint venturers. Thus, A is taxable upon his share of such gross receipts only in the years in which such share is actually paid to him under the terms of the separate agreement. The payments of \$25x in each of the years 1971 and 1972 constitute earned income. The payments of \$25x in each of the years 1973 and 1974 would not constitute earned income because they constitute deferred compensation received later than the end of the first taxable year (i.e., 1972) following the year in which A's right to receive such amounts was not subject to a substantial risk of forfeiture.

[T.D. 7446, 41 FR 55339, Dec. 20, 1976]

SMALL BUSINESS CORPORATIONS AND THEIR SHAREHOLDERS

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[T.D. 8600, 60 FR 37581, July 21, 1995, as amended by T.D. 8869, 65 FR 3848, Jan. 25, 2000; T.D. 8994, 67 FR 34397, May 14, 2002; T.D. 9422, 73 FR 47527, Aug. 14, 2008]