

Capital Construction Fund Frequently Asked Questions

1. WHAT IS THE FISHING VESSEL CAPITAL CONSTRUCTION FUND (CCF) PROGRAM?

Created by the Merchant Marine Act, 1936, as amended (46 U.S.C. 53503), the CCF program enables fishermen to construct, reconstruct or acquire fishing vessels with before-tax, rather than after-tax dollars. It allows fishermen to defer taxable income from operation of their fishing vessels. This deferred tax is recaptured in lieu of depreciation when the capital expenditure is paid for with CCF dollars. The purpose of the CCF program is to improve the fishing fleet by allowing fishermen to accelerate their accumulation of funds with which to replace or improve their fishing vessels.

2. WHO IS ELIGIBLE?

Any U.S. citizen is eligible who owns or leases a U.S.-built fishing vessel of at least 2 net tons and has an acceptable program for constructing, reconstructing or acquiring a fishing vessel of at least 2 net tons. The term "fishing vessel" includes vessels used commercially in the fisheries of the U.S. for catching, transporting, and processing fish. Also included are commercial passenger-carrying vessels used for fishing parties.

3. HOW DO YOU GET INTO THE CCF PROGRAM?

You must enter into a CCF agreement with the Secretary of Commerce through the National Oceanic and Atmospheric Administration (NOAA), National Marine Fisheries Service (NMFS). You may apply at any time; but, to be applicable to any given tax year, a CCF agreement must be executed and entered on or before the due date (with extensions) for filing your Federal tax return for that tax year. A CCF application kit can be obtained from our website at http://www.nmfs.noaa.gov/mb/financial_services/ccf.htm or by contacting NMFS at the following address or phone number:

***NOAA/NMFS, Financial Services Division, F/MB5
Capital Construction Fund Program
1315 East-West Highway, Room 13113
Silver Spring, MD 20910-3282
Telephone: (301)427-8784***

If you decide to enter the CCF program, we urge you to submit your application as soon as possible, or at least 45 days prior to your tax due date to ensure timely execution by NMFS.

4. WHAT WILL THE CCF AGREEMENT ESTABLISH?

A. Which of your fishing vessels will be eligible for deferral of taxable income. These are called "Schedule A" vessels.

B. What kind of qualified vessel (catching, processing, transporting/tendering, or passenger-carrying fishing vessel) you will construct, reconstruct or acquire with the money in your CCF account. These are called "Schedule B" vessels, or objectives.

C. Where you will keep the tax-deferred income you will use to pay for your Schedule B objectives. The place where you will keep this money is called the "CCF depository," and the account is referred to as the "CCF account."

You decide what portion of your taxable income from your Schedule A vessels you want to deposit into your CCF account for the tax year. You then deposit that income into your CCF account in your designated CCF depository on or before your tax due date, with extensions. Thus you have put this deferred taxable fishing income into your own account in your own depository and will have it available to help pay for your Schedule B objectives.

5. HOW DO YOU ESTABLISH THE CCF ACCOUNT?

An Investment Guide showing allowable investments of your CCF money is provided with the application kit. Open an account at the approved CCF depository in the name listed on the CCF Agreement and request that the account title include the word "CCF". The account must be separate from general operating, personal savings or checking accounts, and used only for approved CCF activity. You may, of course, designate more than one depository in your CCF Agreement. After entering the Agreement, additional depositories must be approved by NMFS.

6. WHY SHOULD YOU CONSIDER ENTERING INTO A CCF AGREEMENT AFTER THE END OF A TAX YEAR INSTEAD OF DOING SO FOR THE FOLLOWING TAX YEAR?

There are two advantages. First, deposits into your CCF account made after the tax year's end, but before the due date for filing your Federal return, may be considered as having been made in the previous tax year. Second, NMFS will ratify, as a "constructive" deposit and withdrawal, any otherwise eligible and qualified transaction occurring during the first tax year of your CCF Agreement even though it occurred before applying for and entering the Agreement. The transaction must have been such that it normally would have been qualified under the law had the CCF Agreement existed.

For example, assume you constructed a new fishing vessel in 2016 and did not know of the CCF program until early 2017. You could enter into a CCF Agreement before your tax due date for filing your Federal tax return for 2016, and any payments made on the new vessel in 2016 could be treated as having been "constructively" deposited and "constructively" withdrawn from your CCF account.

7. WHEN ARE CCF DEPOSITS AND WITHDRAWALS CONSIDERED "CONSTRUCTIVE"?

Only in the first taxable year of your CCF Agreement and prior to the effective date of your CCF Agreement. For most applicants, which file their tax returns based on a calendar year, the eligible period for "constructive deposit and withdrawal" treatment would be January 1 through December 31. After the eligible "constructive deposit and withdrawal" period ends, all deposits and withdrawals must be physically made through your designated CCF account in order to qualify.

8. HOW MUCH CAN BE DEPOSITED INTO A CCF ACCOUNT EACH YEAR?

You can deposit during any tax year the total of the following "ceilings" for each "Schedule A vessel" designated in your CCF Agreement:

A. 100 percent of taxable income from vessel operation.

B. 100 percent of vessel depreciation. (See No. 11).

C. 100 percent of net proceeds from the sale or other disposition of vessels.

D. 100 percent of the earnings from investment or reinvestment of amounts deposited. (When you deposit the earnings of the CCF account, you may also defer the Federal taxes on same.)

Although you can deposit up to 100 percent of the amounts listed above, it is up to you to decide how much you actually can or want to deposit. Whatever you deposit cannot, of course, be more than the total amount needed to pay for the cost of all Schedule B objectives. The amount deposited from vessel operations and deferred on your tax return cannot create a loss to your taxable vessel income, but can reduce it to zero.

9. ARE THERE MINIMUM ANNUAL DEPOSIT REQUIREMENTS?

No, minimum annual deposit requirements once existed but were eliminated under our current CCF Regulation.

10. CAN YOU KEEP THE INVESTMENT INCOME (EARNINGS) OF THE CCF ACCOUNT RATHER THAN REDEPOSITING IT?

Yes, the earnings would, however, be taxable income to you. If the earnings are redeposited or left in your CCF account, taxation on these earnings is deferred and is available for payment on your Schedule B objectives.

11. WHAT IS THE ADVANTAGE OF DEPOSITING THE AMOUNT OF VESSEL DEPRECIATION INTO YOUR CCF ACCOUNT?

Although you **do not get an additional tax deduction** for a deposit of depreciation, any earnings of your CCF account as a result of investing the deposit of depreciation may be redeposited and taxation on those earnings deferred. When you are saving towards your CCF objective, this type of deposit can considerably accelerate your accumulation of funds.

12. WHAT HAPPENS IF YOU MAKE CCF DEPOSITS IN EXCESS OF YOUR TAXABLE INCOME OR ANY OTHER CEILING FOR ANY TAX YEAR?

You have several options available. The excess (overdeposit), or any portion thereof, may: (a) be withdrawn as if never deposited; (b) be treated as a deposit under another ceiling, if available; or, (c) be treated as a deposit under any ceiling for the next taxable year, if all ceilings for prior years are filled.

13. WHAT BENEFIT IS DERIVED FROM A CCF DEPOSIT OF THE NET PROCEEDS FROM THE SALE OR OTHER DISPOSITION OF A VESSEL OR FROM INSURANCE OR INDEMNITY ATTRIBUTABLE TO A VESSEL?

If you dispose of a Schedule A vessel and have any gain as a result, tax on the gains realized may, under certain circumstances, be deferred. According to Joint Treasury-Commerce Proposed Rules, tax on that gain may be deferred by depositing the full net proceeds into your CCF account. In order to defer tax on the gain, the full net proceeds of the transaction must be deposited. A deposit of anything less than full net proceeds will not allow a partial deferment. Net proceeds is defined as the excess of gross proceeds after deducting (a) the expense of sale, and (b) mortgages and/or liens outstanding. However, if gain recognized is greater than such excess, net proceeds is the greater amount. Caution--If the purchaser of your vessel pays you the purchase price on the installment plan, you must deposit the amount of the depreciation recaptured in the year of sale, even though you may not receive any payments in the first year.

14. WHEN TAXES ARE DEFERRED USING THE CCF TO PAY FOR CONSTRUCTING, RECONSTRUCTING, OR ACQUIRING VESSELS, DO YOU EVER HAVE TO PAY BACK THOSE TAXES SOMEHOW?

Yes, in a sense. Taxes which are deferred using the CCF program, and used to pay for Schedule B objectives under your CCF Agreement are subject to future "recapture" by the Internal Revenue Service. This "recapture" is accomplished by a reduction in the basis for depreciation of Schedule B vessels. In other words, your future depreciation allowance for Schedule B objectives will be reduced to compensate for the taxes you previously deferred under your CCF Agreement. Although the deferred taxes are eventually "recaptured," your use of those deferred taxes to help pay for the cost of your Schedule B objectives still constitute an interest-free loan from the Government. Since "recapture" of those deferred taxes occurs over the depreciable life of your Schedule B vessels, the interest-free loan aspect of the deferred taxes continues for as long as you still have depreciation to claim on your Schedule B vessels.

15. IF THE BASIS FOR DEPRECIATION OF SCHEDULE B VESSELS MUST BE REDUCED, WHY SHOULD YOU ENTER THE CCF PROGRAM?

Although the future basis for depreciation of your Schedule B vessels must be reduced, remember that you did receive a tax deduction of a like amount in the year in which you made your CCF deposits. Therefore, although you really are not losing anything as a result of this future reduction, you are gaining several things.

First, by accumulating before-tax dollars, rather than after-tax dollars, you can save much more quickly the funds with which to pay a greater portion of the cost of your Schedule B objectives.

Second, deferred taxes constitute an interest-free loan from the Government to you over the depreciable life of your Schedule B vessels.

Third, a CCF Agreement may simply enable some agreement holders to accumulate the required down payment for a Schedule B vessel which they otherwise would have been unable to accumulate. You can then continue to make future tax-deferred deposits into your CCF account after acquiring the Schedule B vessel in order to reduce principal mortgage indebtedness. The fact that depreciation allowances on the Schedule B vessel will be reduced to recapture deferred taxes simply means that you will have more taxable income from the operation of that vessel to deposit into your CCF account for subsequent withdrawal to further pay that vessel's mortgage indebtedness much more quickly, or to save towards a future objective.

16. CAN CCF DEPOSITS BE USED TO PAY ON A MORTGAGE?

Yes, where the cost of constructing, reconstructing or acquiring a Schedule B vessel is financed, payments on the principal part of the original indebtedness can be made through your CCF account. The tax deferral for deposits for making withdrawals for indebtedness can effectively be extended until you no longer have any depreciable basis to reduce or the mortgage is paid off, whichever comes first.

17. WHAT EFFECT DOES BASIS REDUCTION HAVE ON THE FUTURE SALE OF CCF OBJECTIVE VESSELS?

When a Schedule B vessel is sold, any reduction in depreciable basis due to CCF withdrawals is treated the same as depreciation claimed. Thus, any gain on the sale would be reported as ordinary gain. However, if the full net proceeds are deposited into a CCF account, taxation of that gain can be deferred.

18. WHAT REPORTS ON DEPOSIT OR WITHDRAWAL ACTIVITY ARE REQUIRED?

Tax year transactions in your account are reported on NOAA Form 34-82, "Capital Construction Fund - Deposit/Withdrawal Report." This report is due for the first taxable year in which your CCF is effective and each year thereafter within 30 days after the due date for filing your Federal tax return each year. The information on this report certifies to NMFS your CCF account activity for the tax year. Because the CCF is a tax deferred program, NMFS is required by law to report the information to the Secretary of Treasury. You are also required by regulations to submit a complete copy of your Federal return along with the report.

19. IF THE SOURCE OF CCF DEPOSITS (AND THEIR WITHDRAWALS) RECEIVE DIFFERENT TAX DEFERRED TREATMENT, HOW DO YOU KEEP TRACK OF THIS?

Although you have one CCF account, the "final" annual Deposit/Withdrawal reporting form has three separate "bookkeeping accounts," which are designated (a) ordinary income, (b) capital gain, and (c) capital.

20. WHAT IS THE EFFECT OF DEPOSITS INTO THE VARIOUS BOOKKEEPING ACCOUNTS?

A. *The ordinary income account.* Deposits to this account create an immediate income tax deduction of a similar amount from (1) taxable income from operating the Schedule A vessel; (2) the ordinary income portion (depreciation recapture) on the sale of Agreement vessels; and (3) interest and dividend earnings on investments of the CCF account.

B. *The capital gain account.* Deposits to this account also create an immediate income tax deduction from (1) the sale or insurance proceeds of Agreement vessels, and (2) capital gains from investments of the CCF account. (The Tax Reform Act of 1986 requires taxpayers to distinguish in their bookkeeping records between ordinary gains and capital gains).

C. *The capital account.* Deposits to this account DO NOT generate a CCF tax deduction. These are principally deposits from vessel depreciation and the return of capital on the sale or other disposition of Schedule A vessels.

21. WHAT IS THE EFFECT OF WITHDRAWALS FROM THE VARIOUS BOOKKEEPING ACCOUNTS?

Since no income tax is paid on the amounts deposited in the capital gain or ordinary income accounts of your CCF, to recapture that deferred income tax by taxing these deposits when withdrawn for a qualified objective would provide no benefit. Instead the deferred income tax is recaptured by decreasing the depreciable basis of the vessel being constructed, reconstructed or acquired with withdrawals from your CCF account.

A. *The ordinary income account.* Qualified withdrawals from this account reduce the depreciable basis of the Schedule B vessel being constructed, reconstructed or acquired by an amount equal to the withdrawal. Nonqualified withdrawals from this account must be reported on your tax return in the year you make the withdrawal. (See No. 26 for penalty and interest calculations on nonqualified withdrawals).

B. *The capital gain account.* Qualified withdrawals from this account also reduce the depreciable basis of the Schedule B vessel by a pro rata amount of the withdrawal. Nonqualified withdrawals from this account must be reported on your tax return in the year you make the withdrawal. (See No. 26).

C. *The capital account.* All withdrawals from this account are equivalent to a return of capital to you and accordingly have no effect on taxable income or the depreciable basis of Schedule B vessels. This is true whether the withdrawal is qualified or nonqualified, and is due to the fact that you did not receive any income tax deduction at the time of deposit.

22. WHAT ARE "QUALIFIED" AND "NONQUALIFIED" WITHDRAWALS?

Withdrawals from your CCF account approved by NMFS for payment towards your Schedule B objectives are called qualified withdrawals. Withdrawals for any other purpose are called nonqualified withdrawals.

23. CAN YOU CHOOSE THE BOOKKEEPING ACCOUNT FROM WHICH A WITHDRAWAL WILL BE MADE?

No. Qualified withdrawals come, first, from the capital account; second, from the capital gain account; and, last from the ordinary income account. Nonqualified withdrawals are made in the reverse order, first, from the ordinary income account; second, from the capital gain account; and, last from the capital account. Generally, the withdrawals from a particular account are made on a first-in/first-out basis.

24. HOW DO YOU WITHDRAW CCF DEPOSITS?

Before making any CCF withdrawal, you must have NMFS approval. Without NMFS approval, you may jeopardize the tax-deferral associated with any such withdrawal. Once withdrawals are approved by NMFS, however, you simply withdraw the money as you would from any other account. If, however, you make an otherwise qualified payment outside of your CCF account during a particular tax year, you may, with NMFS approval and as a matter of general policy, reimburse yourself from your CCF account on or before your tax due date, with extensions, for filing that year's tax return.

25. WILL NONQUALIFIED WITHDRAWALS BE APPROVED REGARDLESS OF REASON?

No. Nonqualified withdrawals will only be approved for good cause. For instance, should you incur a net operating loss and need funds to continue operation, and after exhausting all other sources of available funding, NMFS would approve a nonqualified withdrawal upon substantiation of the need.

26. ARE THERE ANY PENALTIES CONNECTED WITH AN APPROVED NONQUALIFIED WITHDRAWAL?

Yes. Nonqualified withdrawals are taxed at the highest marginal tax rate in the year of withdrawal. In addition, the tax on the nonqualified withdrawal amount is subject to a self-assessed interest penalty. Withdrawals are made on a first-in/first-out basis and interest is charged from the year of deposit to the year of withdrawal. Nonqualified withdrawal amounts stand alone as income and cannot be used to offset net operating losses.

27. WHAT IF YOU MAKE WITHDRAWALS WITHOUT PRIOR APPROVAL FROM NMFS?

Without NMFS approval, the withdrawal may be considered nonqualified. In addition to the tax consequences of a nonqualified withdrawal, this would be considered a breach of your CCF Agreement and could result in its termination.

28. HOW DO YOU NOTIFY THE INTERNAL REVENUE SERVICE OF YOUR PARTICIPATION IN THE CCF PROGRAM?

Refer to IRS Publication 595, "Tax Guide for Commercial Fishermen," and the IRS Code Section 7518 for guidance in reporting the CCF deferral and CCF basis reduction on your Federal tax return. Any questions with respect to Federal tax returns or related tax matters should be cleared with the IRS since their rulings will be final and binding.

29. DO CCF DEPOSITS ALSO DEFER STATE INCOME TAXES?

If your State has adopted the CCF provisions of Federal law, then your State tax will also be deferred. However, you should check with your State for any exceptions.

30. WHAT ARE THE REQUIREMENTS WHEN ACQUIRING A VESSEL?

CCF funds can be used to acquire any used qualified vessel that will fish in a limited access system in which the fisheries management authority establishes harvesting limits. If the fishery or fisheries is not a limited access system, CCF funds can only be used to replace an existing, recently sunken, or scrapped vessel and its existing harvesting capacity. The replaced vessel must lose its fisheries trade endorsement and the vessel owner must notify the Coast Guard Documentation Center of that fact.

31. WHAT ARE THE REQUIREMENTS WHEN CONSTRUCTING A VESSEL?

CCF funds can be used to construct a new qualified vessel that will fish in a limited access system in which the fisheries management authority establishes harvesting limits. If the fishery or fisheries is not a limited access system, CCF funds can only be used to replace an existing, recently sunken, or scrapped vessel and its existing harvesting capacity. The replaced vessel must lose its fisheries trade endorsement and the vessel owner must notify the Coast Guard Documentation Center of that fact. Construction must be completed within 18 months from the date the construction first commences, unless otherwise consented to by the Secretary.

32. WHAT ARE THE REQUIREMENTS WHEN RECONSTRUCTING A VESSEL?

Reconstruction may include rebuilding, replacing, reconditioning, refurbishing, repairing, converting and/or improving any portion of a vessel. A reconstruction project must, however, either substantially prolong the useful life of the reconstructed vessel, increase its value, materially increase its safety, reliability, or energy efficiency, or adapt it to a different commercial use in the fishing trade or industry. No vessel more than 25 years old at the time of withdrawal shall be a qualified vessel for the purpose of reconstruction unless a special showing is made, to NMFS, that the type and degree of reconstruction intended will result in an efficient and productive vessel with an economically useful life of at least 10 years beyond the date reconstruction is completed. Reconstruction must be completed within 18 months from the date the reconstruction first

33. AFTER ACCOMPLISHING YOUR SCHEDULE B OBJECTIVES, HOW DO YOU TERMINATE A CCF AGREEMENT?

After all requirements are met for accomplishing your objectives, simply notify NMFS in writing that you wish to terminate (close) the Agreement. NMFS will review your file and, if all of your reporting requirements are met, issue you a formal termination letter. Your account is not considered terminated simply because you have closed out your CCF depository account. You are not officially terminated until you receive your formal termination letter from NMFS.

34. WHAT HAPPENS WHEN YOUR CCF AGREEMENT IS TERMINATED?

If the Agreement is terminated, voluntarily or involuntarily, any deposits remaining in the CCF account classified as 'ordinary income' or 'capital gain' deposits will be treated as a nonqualified withdrawal. Refer to No. 26 for information on tax and penalties attributable to a nonqualified withdrawal.

--NOTE--

All attempts have been made in preparing this information to present the material as accurately and technically correct as possible. Nevertheless, this program is jointly administered by NMFS and the Internal Revenue Service and NMFS cannot be responsible for actions taken in reliance on this booklet which may prove to be in variance with regulations, procedures, or determinations of other agencies.

NMFS realizes that there are many facets of the CCF program which are not, and cannot be covered in an informational text of this size. Additional sources which should be consulted about the CCF program are listed below.

- Section 607 of the Merchant Marine Act, 1936, as amended (46 U.S.C. 53503)
- 50 CFR Part 259 (Capital Construction Fund; Fishing Vessel Capital Construction Fund Procedures)
- 26 CFR Part 3.0 through 3.11 (Department of Treasury, Internal Revenue Service, Capital Construction Fund Rules and Regulations)
- Internal Revenue Code Section 7518
- Internal Revenue Service Publication 595, "Tax Guide For Commercial Fishermen"

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