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# Federal Income Tax: Doctrine, Structure, and Policy

## Fourth Edition

## 2017 CUMULATIVE UPDATE FOR STUDENTS AND TEACHERS

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The Fourth Edition was current when it went to press. This cumulative update describes important subsequent developments, the principal ones being the American Taxpayer Relief Act of 2012 (2012 ATRA), the Tax Increase Prevention Act of 2014 (TIPA), the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, and the Protecting Americans from Tax Hikes Act of 2015 (the PATH Act). Because this is a cumulative supplement, new material appears in bold type.

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## Chapter 1

## TAXONOMY, HISTORY, AND THE INSTITUTIONAL STRUCTURE OF TAXATION IN THE UNITED STATES

### Page 5

Recent studies have concluded that the Constitution generally permits Congress to enact retroactive tax legislation as long as the period of retroactivity is not excessive. The Supreme Court has upheld tax laws whose retroactive effect extended into the preceding tax year but has given no clear guidance regarding the constitutional limit on retroactivity. *See* James M. Puckett, *Embracing the Queen of Hearts: Deference to Retroactive Tax Rules,* 40 FLA. STATE L. REV. 349 (2013); ERIKA K. LUNDER, ROBERT MELTZ & KENNETH R. THOMAS, CONSTITUTIONALITY OF RETROACTIVE TAX LEGISLATION (Cong. Res. Serv. Oct. 25, 2012), *available at* assets.opencrs.com/rpts/R42791_20121025.pdf.

### Page 10

Section 6702 allows the IRS to impose a $5,000 penalty on a taxpayer who files a return based on a "frivolous" legal argument and IRC § 6673(a) allows the Tax Court to impose a penalty of up to $25,000 on a taxpayer who brings an action in that court that is based on a "frivolous or groundless" legal position.

### Page 18

Congress reduced the Social Security tax rate on employees from 6.2% to 4.2% for 2011 and 2012, but as of January 1, 2013, the rate returned to 6.2%. The Medicare tax changes described in footnote 17 were not repealed, amended, or delayed by 2012 ATRA. They became effective on January 1, 2013.

### Page 23

Regarding the authoritative status of the Blue Book, see Cole Barnett, *United States v. Woods and the Future of the Tax Blue Book as a Means of Penalty Avoidance and Statutory Interpretation*, 66 FLA. L. REV. 1791 (2014).

### Page 28

In *U.S.* v. *Home Concrete & Supply, LLC,* 132 S. Ct. 1836 (2012), the Supreme Court elaborated on the *Chevron, Brand X,* and *Mayo* line of cases. In *National Cable & Telecommunications Ass'n v. Brand X Internet Services,* 545 U.S. 967 (2005) (discussed in Chapter 15 and generally known as *Brand X),* the Supreme Court extended *Chevron* by holding that a judicial interpretation of an ambiguous federal statute can be reversed by a subsequent administrative regulation that satisfies the two-part *Chevron* test. According to *Brand X,* this administrative reversal power can always be exercised, unless the earlier court decision had held that the statutory provision in question was unambiguous so that the interpretation adopted in the earlier

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decision was the only permissible construction, thus leaving no room for the administrative agency to adopt a different interpretation.

Eight of the Justices in *Home Concrete* held that *Brand X* continues to be a valid gloss on the *Chevron* jurisprudence. However, pre-*Brand X* judicial opinions were written in ignorance of the ambiguous vs. unambiguous dichotomy that was made controlling by *Brand X.* Therefore, courts dealing with regulations purporting to reverse pre-*Brand X* opinions will have to carefully parse the judicial language to determine whether the opinion in question held that the subject statute fell on the ambiguous or unambiguous side of the line.

Neither *Chevron* nor *Brand X* involved a regulation that was issued in the midst of litigation for the purpose of affecting the outcome of that litigation. *Home Concrete* presented the opportunity to decide whether such a regulation qualifies for judicial deference under *Chevron* and *Brand X,* but the Court chose not to address this issue and so it remains an unresolved question. *See generally* Leandra Lederman, *The Fight Over "Fighting Regs" and Deference in Tax Litigation*, 92 B.U. L. REV. 643 (2012).

Recent judicial developments have chipped away at the deference accorded to regulations by *Chevron*. The quotation from *Mead* on page 27 of the casebook is popularly referred to as "*Chevron* step zero." It asks whether Congress has delegated authority to an agency to cure statutory ambiguity or fill statutory gaps and whether the regulation in question was promulgated pursuant to that authority. IRC § 7805(a) is usually regarded as providing the necessary congressional delegation of authority to promulgate income tax regulations and the act of expressly relying on that provision to promulgate a regulation is usually taken as conclusive evidence that the regulation was issued pursuant to delegated authority. Thus, income tax regulations are ordinarily considered to automatically satisfy *Chevron* step zero. This status quo was disturbed by the Supreme Court's opinion in *King v. Burwell*, 135 S. Ct. 475 (2015.)

That case involved the interpretation of an important ambiguous phrase ("Exchange established by the state") in the Affordable Care Act (Obamacare). This phrase controlled the availability of income tax credits for insurance premiums. Although the Act did not expressly give the IRS authority to interpret the phrase in question, such a regulation was promulgated under the authority of IRC § 7805(a). Nevertheless, the Supreme Court effectively held that even though the phrase in question was ambiguous, the regulation was not entitled to *Chevron* deference because it did not satisfy *Chevron* step zero. The Court gave the following explanation:

> Whether those credits are available on Federal Exchanges is thus a question of deep "economic and political significance" that is central to this statutory scheme; had Congress wished to assign that question to an agency, it surely would have done so expressly …. It is especially unlikely that Congress would have delegated this decision to the *IRS*, which has no expertise in crafting health insurance policy of this sort …. This is not a case for the *IRS*.

This quotation seems to create considerable leeway for courts to substitute their judgment for positions taken in income tax regulations when the courts feel that an issue of sufficient importance is involved. *King v. Burwell*, however, ultimately upheld the regulation involved in

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that case but did so on the basis of the Court's independent judgment instead of giving *Chevron* deference to the regulation.

In *Altera Corp. v. Comm'r*, 145 TC 91 (2015), the Tax Court held that *Chevron* step two (whether the agency's interpretation is "based on a reasonable construction of the statute") implicitly incorporates a requirement that a regulation must be the product of the agency's "reasoned decision-making," which means that "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." If this becomes the prevailing judicial view, Treasury will have to make a persuasive showing that the interpretation asserted in a particular regulation was arrived at through an informed and thoughtful process in addition to being a reasonable position.

**Page 30**

***Sunoco, Inc. v. U.S.*, 2016-2 USTC (CCH) ¶ 70, 341 (Fed. Cl. 2016) held that an IRS Notice issued during the pendency of litigation for the purpose of affecting that litigation, that cited no authority, and that was inconsistent with prior IRS pronouncements was not entitled to *Skidmore* deference.**

**Page 32**

In *Kuretski v. Comm'r*, 2014-1 USTC CCH ¶ 50,329 (D.C. Cir. 2014), the D.C. Circuit held that the Tax Court is part of the executive branch of the federal government so that the President's power under IRC § 7443(f) to remove Tax Court judges for good cause does not violate the separation of powers principle of the U.S. Constitution. The Supreme Court has denied certiorari. The PATH Act added the following to IRC § 7441: "The Tax Court is not an agency of, and shall be independent of, the executive branch of the Government." The impact of this language on the separation of powers issue that was adjudicated in *Kuretski* is presently unknown. Neither *Kuretski* nor the PATH Act amendment to IRC § 7441 appear to affect the Supreme Court's decision in *Freytag v. Comm'r*, 501 U.S. 868 (1991). That opinion held that the Tax Court is a "Court of Law" within the meaning of the Constitution's Appointments Clause (U.S. Constitution, Article II, section 2, clause 2) and exercises judicial power even though the Supreme Court also held that the Tax Court is established under Article I of the Constitution rather than Article III. ***Byers v. U.S. Tax Court*, 2016-2 USTC (CCH) ¶ 50,431 (D. D.C. 2016), held that the U.S. Tax Court was a court, not an agency, for purposes of the Freedom of Information Act and was, therefore, exempt from the provisions of that Act.**

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## Chapter 2

## Basic Income Tax Principles

### Page 37

In *Shankar v. Comm'r*, 143 TC 140 (2014), Citibank had credited the taxpayer with 50,000 "Thank you Points" for opening a Citibank account. The taxpayer requested that these points be used to acquire an airline ticket. Citibank purchased the ticket, delivered it to the taxpayer, and issued a Form 1099 showing that the taxpayer had received income equal to the ticket's $668 purchase price. The Tax Court held that this amount was includable in the taxpayer's gross income. **Some bank credit cards offer other rewards (in cash or in kind) not tied to the bank's services (hence, not a price discount). Can these be distinguished from *Shankar*?**

### Page 40

In Notice 2014-21, 2014-16 I.R.B. 938, the IRS held (i) that virtual currency such as Bitcoin is property rather than currency for federal tax purposes, (ii) that a taxpayer who receives virtual currency in exchange for money or property must treat the then fair market value of the virtual currency as an income inclusion or an amount realized, (iii) that such a taxpayer takes a basis in the virtual currency equal to its fair market value at the time of receipt, and (iv) that a taxpayer who pays for goods or services with virtual currency must recognize gain or loss equal to the difference between the currency's then fair market value and the taxpayer's basis. The gain or loss will be capital gain or loss if the virtual currency qualifies as a capital asset in the taxpayer's hands under IRC § 1221.

### Page 50

See entry for **Page 32.**

### Page 52

2012 ATRA continues the generally applicable long-term capital gains rate at 15 percent. However, for "high income taxpayers" (which, generally speaking, means individuals in the 39.6% marginal rate bracket) the generally applicable long-term capital gains rate is now 20 percent.

### Page 57

Jean's deduction for office supplies is allowed by recently promulgated Regs. §§ 1.162-3(a)(2), 1.263(a)-2(c)(2). Reg. § 1.162-3(h) Example 9 assumes that the property therein was not incidental supplies. *See* Reg. § 1.162-3(h) (first paragraph). We assume that Jean's supplies are copier paper, legal pads, pens, and pencils, etc. that qualify as incidental.

### Page 59

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To keep matters simple at this early stage, the discussion of Jean's depreciation deductions intentionally omits consideration of IRC §§ 168(k) and 179. Those provisions, which deviate from the general rules, will be covered in Chapters 6 and 28.

**Page 65**

The above-the-line deduction allowed by IRC § 62(a)(2)(D) for small expenses incurred by K-12 teachers for work-related books, supplies, etc. was made permanent by the PATH Act.

**Page 67**

We were prescient. 2012 ATRA permanently revived IRC § 68 for tax years beginning after December 31, 2012. **For 2017, the adjusted gross income thresholds at which IRC § 68 begins to bite are $313,800 for marrieds filing jointly and for surviving spouses, $287,650 for heads of households, $261,500 for single filers, and $156,900 for marrieds filing separately. *See* Rev. Proc. 2016-55 § 3.15, 2016-45 I.R.B. 707. These thresholds will be annually adjusted for inflation.** Section 68 is popularly known as the "Pease limitation" because it was originally advanced by the late Congressman Donald Pease of Ohio.

**Page 68**

2012 ATRA permanently increased the AMT exemptions, starting in 2012, to $50,600 for singles, $78,750 for marrieds filing jointly and surviving spouses, and $39,375 for marrieds filing separately. These amounts will be annually adjusted for inflation. For 2012 and subsequent years, 2012 ATRA also allows all nonrefundable personal tax credits *(see* IRC §§ 21-25) to be taken against the AMT.

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## Chapter 4

## Rates and Allowances for Basic Maintenance

### Pages 86 and 90

2012 ATRA made no changes to the 10%, 15%, 25%, 28%, and 33% brackets, but added a ceiling to the 35% bracket and created a new 39.6% bracket for income above that ceiling. These changes are permanent.

### Page 92

In *U.S. v. Windsor,* 133 S. Ct. 2675 (2013), the Supreme Court declared Defense of Marriage Act § 3 unconstitutional. The IRS responded by issuing Rev. Rul. 2013-17, 2013-2 C.B. 201, to conform the Internal Revenue Code to *Windsor*. Then in *Obergefell v. Hodges*, 135 S. Ct. 2071(2015), the Supreme Court held that state laws reserving marriage to heterosexual couples are "invalid to the extent they exclude same-sex couples from civil marriage on the same terms and conditions as opposite-sex couples," and also held that "there is no lawful basis for a State to refuse to recognize a lawful same-sex marriage performed in another State on the ground of its same-sex character." **Treasury has now promulgated Reg. § 301.7701-18 to reflect these developments and to supersede Rev. Rul. 2013-17. The new Regulation effectively allows same-gender couples who are considered married under the law of the state where their ceremony occurred to file joint federal income tax returns. If they choose not to file jointly, they must use the IRC § 1(d) rate table for marrieds filing separately, rather than the IRC § 1(c) rate table for unmarried individuals. In contrast, individuals are not considered married for federal income tax purposes if they "have entered into a registered domestic partnership, civil union, or other similar formal relationship not denominated as a marriage under the law of" the U.S. jurisdiction where the relationship was entered into. The new Regulation does not affect Rev. Rul. 58-66, which holds that a couple will be treated as husband and wife for federal income tax purposes if they have entered into a common law marriage in a state that recognized their relationship as a valid marriage even if they are now living in a state that does not recognize their common law marriage.**

### Page 95

2012 ATRA granted marriage penalty relief by permanently providing that the 15% bracket for joint filers and surviving spouses is twice the size of the 15% bracket for singles.

### Page 98

2012 ATRA granted additional marriage penalty relief by permanently providing that the standard deduction for joint filers and surviving spouses is twice the size of the inflation-adjusted standard deduction for singles and marrieds filing separately.
2012 ATRA restored the personal exemption phase-out (popularly known as the PEP and referred to on page 103). This phase-out reduces each individual taxpayer's total amount of personal exemption deductions by 2% for each $2,500, or fraction thereof, of the taxpayer's adjusted gross

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income in excess of the taxpayer's "applicable amount." However, if the taxpayer is married filing separately, the preceding $2,500 amount is reduced to $1,250. The applicable amounts, to be inflation adjusted after 2013, are:

$300,000 for joint filers and surviving spouses

$275,000 for heads of households

$250,000 for singles

$150,000 for marrieds filing separately.

**Page 105**

Errata: The adoption credit is governed by IRC § 23 and excess credits are non-refundable but benefit from a 5-year carryforward.

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## Chapter 5

## Deductions for Off-the-Bottom Personal Expenses

### Page 112

In *Peery v. Comm'r*, T.C. Memo. 2014-151, the Tax Court held that because a separation agreement characterized a particular cash payment as a "property settlement," the payment was automatically considered to be designated by the parties as not includable in gross income and not deductible under IRC § 215. Therefore, IRC § 71 (b)(1)(B) was not satisfied and the payment did not qualify as alimony or separate maintenance for purposes of IRC §§ 71(a) and 215(a).

### Page 116

The PATH Act made permanent the election to deduct general sales taxes in lieu of state and local income taxes.

### Page 128

**For tax years ending before January 1, 2017, IRC § 213(f) applied a 7.5% medical expense deduction floor to taxpayers aged 65 or older. That floor has expired and the 10% floor now applies to all taxpayers.**

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## Chapter 6

## Viewing the Income Tax Through a Consumption Tax Lens

### Page 157

The PATH Act makes permanent IRC § 179's $500K and $2M limitations and indexes them for inflation. The Act also makes permanent the IRC § 179 deduction for off-the-shelf computer software. Although the 100% deduction under IRC § 168(k) was not extended, the 50% deduction under § 168(k) was extended by the PATH Act, primarily for property placed in service before January 1, 2018. The PATH Act generally reduces the 168(k) deduction to 40% for property placed in service in 2018 and to 30% for property placed in service in 2019. *See* IRC § 168(k)(6).

### Page 158

The depreciation deduction referred to in footnote 30 is made permanent by the PATH Act, primarily for property placed in service before January 1, 2020 but the 100% deduction under IRC §168(k) expired at the end of 2011 and was not revived.

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## Chapter 7

## The Capitalization Principle in Practice

### Page 170

Note 2 refers to a *de minimis* rule in Reg. § 1.162-6. Effective January 1, 2014, that Regulation is repealed and replaced by a more complex *de minimis* rule that requires the taxpayer to have a professionally prepared financial statement of the type used for government reporting or financial transaction purposes. The new rule requires the taxpayer to show the costs in question on the financial statement as expenses and requires that the total aggregate amounts be quite small. *See* Reg. §§ l.162-3(f), l.162-3(h), Example 14, 1.263(a)- 1(f)(1), 1.263- 1(f)(7) Examples 4, 6. These changes will make the *de minimis* rule unavailable to most taxpayers.

### Page 174

As explained above, Reg. § 1.162-6 is repealed effective January I, 2014. Its replacement is too complex to warrant coverage in the basic tax course. Therefore, Problem 2.(b) can be omitted.

### Page 177

In Problem 1, Reg. § 1.263(a)-2(e) is repealed and replaced by Reg. §§ 1.263(a)-1(d), (e), 1.263(a)-2(f)(3), and 1.263(a)-2(f)(4), Example 1, effective January 1, 2014.

### Pages 184-87

Delete everything from the beginning of page 184 up to the Problems on page 187 and insert the following:

> Effective January 1, 2014, the material on pages 184-187 up to the Problems was superseded by new Reg. § 1.263(a)-3. This new Regulation provides that an expenditure qualifies as a deductible repair expense if it is incurred with respect to a unit of business or investment property and if
>
> (1) The expenditure is *not* for a betterment to the unit of property,
>
> (2) The expenditure does *not* restore the unit of property, and
>
> (3) The expenditure does *not* adapt the unit of property to a new or different use.
>
> An expenditure that effects either a betterment, restoration, or adaptation is, generally speaking, not a deductible repair expenditure unless it is covered by the *de minimis* exception that is limited to $5,000 in some cases and $2,500 in others (Reg. § 1.263(a)-1(f); Notice 2015-82, 2015-50 I.R.B. 133) or is covered by the small taxpayer exception (Reg. § 1.263(a)-3(h)), or the routine maintenance exception (Reg. § 1.263(a)-3(i)).

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The new Regulation provides highly detailed rules for determining what constitutes a unit of property and for defining "betterment," "restore," and "adapt to a new or different use." Although these rules generally follow the superseded material in the casebook, they make some changes. More importantly, they are much more complex and lengthy than the old rules and they include 116 dense examples that are essential to understanding the new regime. Intensive consideration of such specialized and intricate material must be reserved for an advanced course; far too much time would be required than can be justified in the basic income tax course. The best approach for the basic course is to give students an experience that provides a sense of the new Regulation's underlying principles and of the process for getting answers from complex material. We recommend going directly from page 183 to the Problems on page 187 and working those Problems by referring to the Regulations cited below and by assuming that neither the *de minimis* exception, the small taxpayer exception, nor the routine maintenance exception applies.

> Problem 1, *see* Reg. § 1.263(a)-3(d) ("generally must capitalize")
>
> Problem 2(a), *see* Reg. § 1.263(a)-3(j)(3), Example 13; Reg. § 1.263(a)-3(k)(7), Examples 14 and 15; Reg. § 1.263(a)-3(l)(1), (2).
>
> Problems 2(b), (c), *see* Reg. § 1.263(a)-3(j)(3), Examples 1 and 2, and Regulations cited with respect to Problem 2(a).
>
> Problem 2(d), *see* Reg. § 1.263(a)-2(d)(1); Reg. § 1.263(a)-3(j)(1)(ii); Reg. § 1.263(a)-(3)(j)(3), Example 7.
>
> Problem 2(e), *see* Reg. § 1.263(a)-3(j)(3) Examples 6, 8; Reg. § 1.263(a)-3(k)(7), Examples 24, 28, 29.
>
> Problem 2(f), *see* Reg. § 1.263(a)-3(k)(1); Reg. § 1.263(a)-3(k)(7), Example 3.

For more details, *see* Carol Conjura, Catherine A. Fitzpatrick, Keith Jordan & Karen Messner, *Repairs vs. Capital Improvements: Do the Final Regulations at Last Clarify the Distinction?*, 119 J. TAX'N 204 (Nov. 2013); W. Eugene Seago, *"Improvements" Under the Repair Regulations*, 142 TAX NOTES 639 (2014).

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## Chapter 8

## The Basic Framework Governing Business and Investment Deductions

### Page 207

With respect to Note 2(b), recently issued Regulations, effective January 1, 2014, provide that expenses incurred by a real property owner to resist a local government's exercise of eminent domain with respect to the property and a local government's establishment of a building line on the property were amounts paid to defend title to property and had to be capitalized. *See* Reg. § 1.263(a)-2(e)(2), Examples 1 and 3.

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**Chapter 9**

**Defining the Personal Realm: Of Human Capital**

**Pages 222-23**

2012 ATRA permanently extended the IRC § 127 exclusion for certain employer provided education.

The PATH Act extended the IRC § 222 deduction for "qualified tuition and related expenses" to cover expenses paid before January 1, 2017. **Section 222 had not been extended beyond 2016 when this update was written.** The HOPE credit's $2,500 limit, partial refundability, and four-year coverage were extended by 2012 ATRA to apply to tax years beginning before 2018.

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## Chapter 10

## Dual Purpose Outlays

### Page 239

In *Park v. Commissioner,* 722 F.3d 384 (D.C. Cir. 2013), the IRS argued that the approach taken in GLAM 2008-011 applied only to U.S. citizens and resident aliens. The District of Columbia Circuit rejected this approach, reversed the Tax Court, and held that the "gambling session" interpretation of "wagering transaction," adopted in GLAM 2008-011, also applied to nonresident aliens.

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## Chapter 11

## Allocating Costs Between the Income Production and Personal Realms

### Page 266

**In *Liljeberg v. Comm'r*, 148 TC ___ No. 6 (2017), foreign students had worked in the United States at summer jobs under a U.S. State Department cultural exchange program and had then returned to their home countries as required by the program's terms. The parties agreed that the students' wages were includable in gross income and that their summer work constituted carrying on a trade or business. The students claimed IRC § 162 business expense deductions for their airfare, travel health insurance, and meals and entertainment. None of the students had continuing home country employment or business activities from which they were temporarily absent during their summer in the United States nor did any applicable provision of law require them to maintain an "abode" in their respective home countries while they were working in the United States. Therefore, the Tax Court disallowed the claimed deductions because they failed the "away from home" requirement of IRC § 162(a)(2) in spite of the temporary character of the students' U.S. employment. The Tax Court also held that even though the students' health insurance expenses were required by terms of the State Department program, they were personal expenses that only could be deducted subject to the 10 percent floor of IRC § 213.**

### Page 271

In Rev. Proc. 2013-13, 2013-6 I.R.B. 478, the IRS promulgated a simplified optional method for calculating home office deductions that otherwise satisfy the requirements of IRC § 280A(c)(1). The optional deduction is $5 per square foot up to a maximum of 300 square feet.

Treasury has issued Final Regulations, effective for tax years beginning after August 1, 2013, dealing with reimbursed expenses covered by IRC § 274(e)(3). The Regulations generally track the book text and the Code language and contain no surprises.

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**Chapter 12**

**Forms of Compensation Income**

**Page 278**

See entry for **Page 32**.

**Page 288**

***Jacobs v. Comm'r*, 148 TC ___ No.24 (2017) involved the Boston Bruins National Hockey League team. The team's contracts with hotels where it stayed when travelling to away games required the hotels to provide pre-game meals in hotel space for all players and accompanying management and support personnel. Substantial pre-game preparation and other management activities occurred during the meals. The recipients got the meals for free. The team also used its contracted sleeping rooms and other hotel space for player rest, player strength and conditioning work, and treatment of player injuries. The Tax Court held that (i) the hotel meal rooms were eating facilities operated by the team for purposes of IRC § 132(e)(2), (ii) the contracted hotel space constituted business premises of the employer for purposes of IRC § 132(e)(2)(A) and IRC § 119(a)(1), and (iii) the meals were furnished for the convenience of the employer within the meaning of IRC § 119(a) so that the meal recipients were deemed by the last sentence of § 132(a)(2) to have paid the direct operating costs of the meals as required by IRC § 132(e)(2)(B). Therefore, the IRC § 274(n)(2)(B) exception to the IRC § 274(n)(1) 50 percent disallowance rule applied and the team's cost for the meals was fully deductible.**

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## Chapter 14

## Recoveries for Personal Injury Other Windfall Receipts

### Page 320

The PATH Act added new IRC § 139F to the Code. It provides a gross income exclusion for the entire amount of any wrongful conviction award to an individual who was wrongfully convicted under state or federal criminal law and who served at least part of the related sentence. *In re Elkins*, 2016 Bankr. LEXIS 2291 (2016) is a decision by the U.S. Bankruptcy Court for the Northern District of Ohio. It holds that IRC § 139F applies only to damages received by the wrongfully convicted individual and not to derivative awards made to family members of that individual.

### Pages 321-23

Treasury has promulgated new Regulations under IRC § 104(a)(2) that neither change nor add to the discussion in the book. See Reg. § 1.104-1. Disappointingly, the Regulations do not clarify the distinction between personal physical injuries and personal non-physical injuries.

In *Perez v. Comm'r*, 144 TC 51 (2015), the taxpayer "donated" her eggs to infertile couples and received $20,000 for doing so. The "donation" contracts stated that this was consideration for pain and suffering incident to the donation procedure and not for sale of the eggs. Taxpayer contended that the consideration was excludable under IRC § 104(a)(2). The Tax Court held that the consideration was not damages for a personal injury within the meaning of IRC § 104(a)(2) but was, instead, includable in gross income as compensation for services.

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## Chapter 15

## Gratuitous Transfers

### Page 332

In the fifth line, delete "trust" from "business trust accounting."

### Page 333

In the last line of the second paragraph, the numerical expression should read: $54 (.35 x $154).

### Pages 335-36

The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 adds new IRC § 1014(f)(1) to the Code. Generally speaking, this new provision states that for income tax purposes, the basis of inherited property cannot exceed its federal estate tax value. This Act also adds to the Code a new IRC § 6035 that directs executors of estates required to file a federal estate tax return to furnish each recipient of a property bequest and the IRS with an information return. The information return must show the estate tax value of the property bequest.

### Page 351

Rev. Proc. 2013-16, 2013-7 I.R.B. 488, holds that principal reductions in the mortgage on a taxpayer's principal residence pursuant to the federal government's Home Affordable Modification Program are excludable from the taxpayer's gross income under the general welfare exclusion.

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**Chapter 17**

**Income Shifting Strategies**

**Page 387**

**The IRS has established a practice of allowing employees to effectively transfer the cash equivalent of certain employment benefits to charitable organizations without suffering an income inclusion. For example, in Notice 2014-68, 2014-47 I.R.B. 842, the IRS addressed employer-established programs under which employees elected to give up vacation, sick, or personal leave in exchange for the employer contributing cash to IRC § 170(c) organizations for the benefit of victims of the West African Ebola epidemic. The Notice states that the IRS would not treat such cash payments as gross income or wages of the participating employees if the payments were made before January 1, 2016. Nor would the IRS treat the opportunity to participate in this type of program as causing employees to be in constructive receipt of income. The employees could not claim a charitable contribution deduction with respect to these payments but the respective employers could deduct the payments under IRC § 162 if the requirements of that provision were satisfied. The IRS issued similar guidance in Notice 2016-55, 2016-40 I.R.B. 432, regarding contributions to assist Louisiana storm victims and Notice 2016-69, 2016-51 I.R.B. 832, regarding contributions for the benefit of Hurricane Matthew victims.**

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## Chapter 18

## Borrowing, Lending, and Interest

### Page 426

In *Voss v. Comm'r*, 796 F3d 1091 (9th Cir. 2015), the Ninth Circuit reversed the Tax Court and held that individual co-owners of a qualified residence who are not married to each other are each entitled to a separate IRC § 163(h)(3) $100,000 and $1 million limitation with respect to the qualified residence. The IRS has now acquiesced in the Ninth Circuit decision. *See* 2016-31 I.R.B. 193.

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**Chapter 19**

**Cancellation-of-Debt Income**

**Page 436**

In the fourth line, substitute “side” for “sits.”

**Page 448**

**Recently, some for-profit schools have closed under circumstances that allow thousands of students and parents to have education loans discharged under the U.S. Department of Education’s Closed School Discharge Process. The resulting debt discharge income is excluded from gross income by 20 USC § 1087, a provision not included in the Internal Revenue Code. Borrowers who do not meet the requirements of the Closed School Discharge Process might nevertheless have education debt discharged under the Education Department’s Defense to Repayment Discharge Process. There is no statutory exclusion for this type of debt discharge income but Rev. Proc. 2017-24, 2017-7 I.R.B. 916 § 2.03, provides that the income will be excluded if the debt was induced by fraud.**

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**Chapter 20**

**Debt and Property**

**Page 456**

**The PATH Act extended IRC § 108(a)(l)(E), (h) through the end of 2016 but there was no further extension at the time this update was written.**

**Page 462**

In the third paragraph, fourth line, substitute "$10K basis" for "$10 basis."

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## Chapter 23

## Tax Accounting Methods

### Page 543

It is well established that a cash method taxpayer is not considered to have made an interest payment merely because the interest is added to the debt principal. *See, e.g., Hargreaves* v. *Commissioner,* TC Sum. Op. 2013-37.

### Page 572

The installment method can affect the tax rate because the applicable rate with respect to a particular installment payment is the one that is in effect at the time the payment is received. Thus, 2012 ATRA's increase in the generally applicable long-term capital gain rate from 15% to 20% means that long-term capital gain installment payments received in tax years beginning before January 1, 2013 will generally be taxed at a maximum of 15% while those received in tax years beginning after December 31, 2012 will generally be taxed at up to 20%.

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## Chapter 24

## Realization of Loss on the Destruction or Theft of Property

### Pages 583-84

Chief Counsel Memorandum 201529008 (Feb. 4, 2015), held that collision damages to a rental car company's vehicles did not qualify as casualties within the meaning of IRC § 165 "because it is normal and expected that its vehicles will be damaged when it rents such vehicles to numerous customers to be operated over public highways." Because the rental car company did not repair the damage in question, a repair expense deduction was not available.

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## Chapter 25

## Capital Gains and Losses

### Page 601

In *Long v. Comm'r*, 772 F. 3d 670 (11th Cir. 2014), the taxpayer entered into a contract to acquire real property. The seller unilaterally terminated the contract and the taxpayer sued for specific performance. During the litigation's pendency, which extended for more than one year, the taxpayer sold his interest in the litigation. The Tax Court held that the taxpayer realized ordinary income from the sale because the land would have been IRC § 1221 (a)(1) property in the taxpayer's hands if the contract had been performed. The Eleventh Circuit reversed and held that the thing sold by the taxpayer was his interest in the litigation, which was distinct from the land in question. The court ruled that this litigation interest was not held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business nor was it disqualified from capital asset characterization by the Supreme Court's decision in *Hort v. Comm'r*. Therefore, the taxpayer's sale gain was long-term capital gain. **What result under the Eleventh Circuit decision if the terminated contract had been an employment contract and all other facts were unchanged?**

### Page 610

**In *Greenteam Materials Recovery PN v. Comm'r,* T.C. Memo 2017-122, the taxpayer sold its contractual rights to provide waste-collection services for certain California municipalities within certain defined areas. The Tax Court held that these contracts were franchises within the meaning of IRC § 1253(b)(1) and that because the taxpayer retained no post-sale interest of any kind in the contracts, § 1253(a) required that the sales be treated as sales or exchanges for capital gains purposes. Section 1253 does not, however, expressly state that sales or exchanges of franchises automatically produce capital gains and, as explained at casebook page 610, it is settled law that sales or exchanges of contracts to perform future services yield ordinary income. Nevertheless, in this case, the Tax Court held that because the services contracts were franchises that had been sold without any type of retained interest on the part of the seller, the following language of IRC § 1253(a) implied that the seller's profit was capital gain:**

> **A transfer of a franchise…shall not be treated as a sale or exchange of a capital asset if the transferor retains any significant power, right, or continuing interest with respect to the subject matter of the franchise….**

**It seems clearly incorrect to hold that this off-point language means that a sale of a franchise automatically yields capital gain whenever the seller does not retain a prohibited interest in the franchise. The Tax Court cited the Fifth Circuit decision in *McInvale v. Comm'r,* 936 F. 2d 833 (5th Cir. 1991) as adopting this interpretation of IRC § 1253(a) but that appears to stretch *McInvale* beyond its actual holding.**

### Page 612

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The PATH Act amended IRC § 1202(a)(4) to provide a 100% exclusion of gain from the sale or exchange of qualified small business stock held for more than 5 years where such stock was acquired after September 27, 2010. This provision also makes the alternative minimum tax inapplicable to such gain.

**Pages 616 and 623**

*See* the entry for **Page 52** regarding the increase in the maximum generally applicable long-term capital gains rate from 15% to 20%. In addition, starting in 2013, higher income taxpayers must pay an additional Medicare tax of 3.8% on net investment income in excess of certain levels. *See* IRC § 1411. Thus, in the generally applicable worst case scenario, long-term capital gains will be taxed at a 23.8% maximum rate.

2012 ATRA made permanent the zero rate for individuals with adjusted net capital gains that would otherwise bear the 10% or 15% ordinary income rate. The 28% maximum rate that applies to collectibles net capital gain and to the non-excluded portion of gain referred to in IRC § 1202(a)(1) and the 25% maximum rate for unrecaptured IRC §1250 gain were all permanent prior to 2012 ATRA and were unaffected by that legislation. 2012 ATRA made permanent the favorable treatment of qualified dividend income in IRC § 1(h)(11).

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## Chapter 26

## Recoveries of Expense Items: The Effect of Annual Accounting on Basis and Basis Recovery

### Page 635

In *Cosentino v. Comm'r*, T.C. Memo. 2014-186, taxpayers engaged in a tax shelter transaction that they would not have pursued but for the advice of accountants to do so. When the taxpayers were required to pay federal and state income tax deficiencies because the tax shelter was legally ineffective, they received a damages settlement from the accountants. The Tax Court followed *Clark v. Comm'r* and, in simplified terms, excluded the settlement portion that reimbursed the taxpayers for undeducted professional fees, taxes, and penalties that they paid because they entered into a transaction that they would not have engaged in but for the accountants' defective advice. The IRS did not appeal but it issued an Action on Decision stating that it would not follow *Cosentino* because the taxpayers in that case were reimbursed by the accountants for income taxes, interest, and penalties that were lawfully due on a transaction actually entered into. The IRS stated that *Clark* was distinguishable because the taxpayer in that case was reimbursed for additional taxes paid on account of an improvident joint return election made in reliance on a return preparer's bad advice. *See* AOD 2016-01. **The IRS did not mention that the damages received in *Cosentino* served to reimburse the taxpayer for an actual and undeducted loss**.

A persistent health-threatening natural gas leak from a public utility's storage facility required nearby residents to relocate for 3½ months. The relevant regulator ordered the utility to pay or reimburse the residents for their clean-up and temporary relocation expenses including hotel costs and pet boarding fees. In Announcement 2016-25, 2016-31 I.R.B. 1, the IRS stated that it "will not assert that an affected area resident must include these payments or reimbursements in gross income." Although no authority is cited, the IRS position is presumably based on the rationale that the residents' relocation costs created basis for them in claims against the utility which, per *Clark*, offset the utility's payments and reimbursements.

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**Chapter 28**

**Depreciation**

**Pages 702-03**

*See* the entries for Page 157 and Page 158.