■

TAXATION OF INDIVIDUAL INCOME

TWELFTH EDITION

■

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Preface

Federal tax law has changed in some important ways since the publication of Taxation of Individual Income, Twelfth Edition in 2018. Legislative developments include various provisions of the American Rescue Plan Act of 2021, the Consolidated Appropriations Act, 2021, the Further Consolidated Appropriations Act, 2020 (which incorporates the Setting Every Community up for Retirement Enhancement (SECURE) Act), and the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Administrative developments include Treasury's promulgation of proposed and final regulations interpreting and applying certain provisions of the Tax Cuts and Jobs Act of 2017. Judicial developments are reflected in the decisions rendered by the Tax Court and other federal courts addressing the proper application of various Code sections. This Supplement highlights these legislative, administrative, and judicial developments as they relate to topics discussed in *Taxation of Individual Income, Twelfth Edition*.

Chapter 1

Introduction to Federal Income Taxation

Page 14: Add to Footnote 3 that for 2022 the basic standard deduction is $25,900 on a joint return and is $12,950 on the return of an unmarried individual (not a surviving spouse or head of household). Rev. Proc. 2021-45, I.R.B. 2021-48.

Page 19: Tax Rates. As noted, the tax rate tables under § 1 are adjusted annually for inflation. The tables for 2022 are contained in Rev. Proc. 2021-45, I.R.B. 2021-48.

Chapter 3

The Effect of an Obligation to Repay

Page 57: Following the carryover paragraph at the top of the page, insert:

In *Novoselsky v. Commissioner*, T.C. Memo. 2020-68, the Tax Court restated its position on determining whether a transfer of funds is a loan or a taxable payment. The taxpayer, who "practiced law with a focus on class action litigation," entered into "litigation support agreements" pursuant to which various persons made up-front payments to him to support the cost of litigation. Under the terms of these agreements, if the litigation was successful the taxpayer repaid the up-front payment plus a premium; if not, the taxpayer was under no obligation to make repayment. The taxpayer took the position the up-front payments were loans. The Tax Court held they were gross income.

> Because a genuine loan is accompanied by an obligation to repay, loan proceeds do not constitute income to the taxpayer.... For this rule to apply, however, the obligation to repay 'must be unconditional and not contingent upon some future event'.... Where an obligation to pay arises only upon the occurrence of a future event, we have consistently held that a valid debt does not exist for Federal tax purposes....

The Tax Court held this same analysis applied here, where repayment of the up-front payments was conditioned on the outcome of litigation. The court went on to state that it would reach the same conclusion — i.e., the upfront payments were income, not loans — under a so-called multifactor analysis, noting:

> [Taxpayer] did not execute a formal promissory note, no fixed schedule for repayments was established; [taxpayer] provided no collateral or security; and no payments of principal were ever made.... [No] interest or other amount was ever paid.... Most importantly, the parties did not conduct themselves as if the transactions were bona fide loans.

Chapter 5

Gifts, Bequests and Inheritance

Page 112: Insert the following after the *Goodwin* case:

In *Felton v. Commissioner*, T.C. Memo. 2018-168, the Tax Court concluded that voluntary payments from members of a congregation to a pastor were income, not gifts. The court in *Felton* reviewed the caselaw on donations to clergy and found that four factors were important in distinguishing between income and gifts: (1) "whether the donations are *objectively* [emphasis added] provided in exchange for services;" (2) "whether the cleric (or other church authorities) requested the personal donations;" (3) "whether the donations were part of a routinized, highly structured program, and given by individual church members or the congregation as a whole;" and (4) "whether the cleric receives a separate salary from the church and the amount of that salary in comparison to the personal donations." In its assessment of the facts, the court concluded that income characterization was appropriate, given that factors (1), (3), and (4) supported such characterization, and noting in particular, with regard to factor (4), that the purported gifts were "around double the total of his deemed salary and parsonage allowance for both of the years at issue."

The same result obtained in another case, *Brown v. Commissioner*, T.C. Memo. 2019-69, involving purported gifts to a pastor from members of his congregation. The court in *Brown* applied the four-factor test noted above in *Felton* and found that all four factors supported income characterization. As it did in *Felton,* the court in *Brown* found that "when comparatively so much money flows to a person from people for whom he provides services (even intangible ones), and to whom he expects to provide services in the future, we find it to be income and not gifts."

Chapter 7

Scholarships and Prizes

Page 137: Add to the last paragraph's discussion of § 127:

> Pursuant to the CARES Act, as amended by the Consolidated Appropriations Act, 2021, for the years 2020 through 2025, "educational assistance" eligible for exclusion from an employee's income under § 127 includes an employer's payment of principal or interest on an employee's qualified education loan. § 127(c)(1)(B), as amended.

Chapter 8

Life Insurance and Annuities

Page 158: In Problem 2 assume that the early distribution penalty of § 72(t) is inapplicable.

In Problem 3, assume the distribution is not exempted from the § 72(t) early withdrawal penalty. Additionally, assume no part of the distribution could qualify for the special rule of § 72(t)(2)(H) [added by the SECURE Act (Setting Every Community Up for Retirement Enhancement Act)] which negates any early distribution penalty on distributions of up to $5,000 made "during the 1-year period beginning on the date on which a child of the individual is born or on which the legal adoption by the individual of an eligible adoptee is finalized."

Page 160: The SECURE Act, enacted in December 2019, repealed § 219(d)(1) which had disallowed deductions for "qualified retirement contributions for the benefit of an individual who had attained the age of 70 ½ before the close of such individual's taxable year for which the contribution was made." As a result, contributions for the benefit of an individual can continue after the individual has attained the age of 70 ½.

Page 161: The Tax Court in *Conard v. Commissioner*, 154 T.C. 96 (2020), held that "applying the §72(t) additional tax to the qualified retirement plan distributions [received by a taxpayer] while she was not yet 59 ½, was not disabled, and was otherwise not eligible for any of the other exceptions described in § 72(t)(2), does not violate the equal protection component of the Due Process Clause of the Fifth Amendment."

Page 161 (*A. Deductible IRAs* — The Investment for Retirement Purpose): The Secure Act amended § 401(a)(9)(C)(i)(I) by striking "70 ½" and inserting "age 72." Thus, distributions from an IRA must commence by April 1 of the year following the year the taxpayer reaches age 72. (See § 408(a)(6)).

Page 161 (*B. Nondeductible IRAs* — Nondeductible Contribution Limits): As a result of the SECURE Act's repeal of § 219(d)(1), contributions to nondeductible

IRAs may be made even after the individual attains the age of 70 ½. See § 408(o)(2)(B)(i).

Page 161 (*B. Nondeductible IRAs* — The Investment-for-Retirement Purpose): As in the case of deductible IRAs, distributions from nondeductible IRA's no longer must commence by April 1 of the year following the year the taxpayer reaches the age of 70 ½. See § 401(a)(9)(C)(i)(I).

Page 162 (*Roth IRAs* — Contribution Limits): Substitute for the last sentence of this paragraph the following sentence:

> Contributions to Roth IRAs, unlike contributions to deductible and nondeductible IRAs, may be made for the benefit of an individual after the individual has reached the age of 72.

Page 162 (*Roth IRAs* — The Investment-for-Retirement purpose): Substitute the following sentence for the sentence in the casebook:

While Congress established the Roth IRA to encourage investment for retirement, that purpose is undercut somewhat by (1) a taxpayer's ability to make contributions to the Roth IRA regardless of the taxpayer's age; (2) the lack of a requirement for distribution when a taxpayer reaches age 72; and (3) the special ordering rule for distributions not qualifying for exclusion.

Chapter 9

Discharge of Indebtedness

Page 172: After the first full paragraph, insert the following:

In *Hamilton v. Commissioner*, T.C. Memo. 2018-62, the Tax Court considered whether money transferred to the taxpayers' son had to be considered in determining the taxpayers' insolvency status under § 108(a)(1)(B). Mr. Hamilton, who became permanently disabled as a result of certain injuries, sought relief from education loans taken out for the education of taxpayers' son. The lender ultimately discharged education loans amounting to approximately $158,500. In the same year as the discharge of the education loans, Mr. Hamilton received a $308,105 nontaxable cash distribution relating to his interest in a limited liability company. His spouse, apparently concerned about her husband's erratic spending, transferred $323,000 to their son's savings account. In turn, the son gave his mother his electronic banking username and password and gave her permission to transfer funds from his savings account. Mrs. Hamilton regularly transferred money from the son's savings account to the taxpayers' joint account, from which she paid a majority of the household bills.

On their tax return for the year, the taxpayers, claiming to be insolvent, did not include any discharge of indebtedness income. Challenging the taxpayers' position, the Service argued that the taxpayers' son held his savings account as a nominee for the taxpayers, and, accordingly, his savings account should be taken into consideration in determining taxpayers' insolvency status.

In resolving the issue, the Tax Court looked first to applicable state law, noting that Utah courts use the following six factors to determine whether a nominee relationship exists:

> (i) the taxpayer exercises dominion and control over the property while the property is in the nominee's name; (ii) the nominee paid little or no consideration for the property; (iii) the taxpayer placed the property in the nominee's name in anticipation of a liability or lawsuit; (iv) a close relationship exists between the taxpayer and the nominee; (v) the taxpayer continues to enjoy the benefits of the property while it is in the nominee's name; and (vi) the conveyance to the nominee is not recorded.

Applying these factors and concluding the taxpayers had failed to establish that their son was not a nominee, the Tax Court emphasized that (a) Mrs. Hamilton exercised dominion and control over her son's bank account; (b) the taxpayers' son provided no consideration for the funds transferred to his bank account; and (c) the taxpayers continued to enjoy the benefits of the transferred funds. Accordingly, the Tax Court concluded the son held the savings accounts as nominee for the taxpayers and, as a result, the taxpayers were not insolvent and the discharged debt was includible in the taxpayers' gross income.

On appeal, the Tenth Circuit Court of Appeals affirmed, holding that the Tax Court "appropriately applied the substance-over-form doctrine to characterize the disputed funds as the Hamiltons' assets for purposes of the insolvency exception ... and properly concluded they exercised effective ongoing control over these funds." *Hamilton v. Commissioner*, 955 F.3d 1169, 1173 (2020).

Page 176: Delete Footnote 13. As noted below, the text of § 108(f)(5) has been completely rewritten by the American Rescue Plant Act of 2021.

Page 177: After the carryover paragraph, add the following new paragraph:

> The American Rescue Plan Act of 2021, however, has considerably expanded the exclusion for forgiven student loans discharged after 2020 and before 2026. Pursuant to § 108(f)(5), as amended by the Act, the exclusion for those years is not limited by the § 108(f)(1) requirement that the individual work "for a certain period of time in certain professions for any of a broad class of employers." Amended § 108(f)(5) essentially removes this limitation for the years 2021 through 2025 and generally excludes forgiven student loans from income, with the caveat that the exclusion does not apply to loans forgiven for services rendered.

Page 177: Add to Footnote 14 that the § 108(a)(1)(E) and (h) exclusion for the discharge of "qualified personal residence indebtedness" has been extended through 2025 by the Consolidated Appropriations Act, 2021, and the acquisition indebtedness eligible for exclusion has been reduced to $750,000 ($375,000 for a married individual filing a separate return) effective in 2021.

Page 178: At the end of 8. Qualified Real Property Business Indebtedness, add the following**:**

While the basis reduction ordinarily occurs in the year following the discharge of indebtedness, per § 1017(a), *Hussey v. Commissioner*, 156 T.C. No. 12 (2021), provides an instance where the basis reduction occurs in the year of discharge when the taxpayer sells, in that year, depreciable real property used to establish the taxpayer's aggregate bases exceeded the amount discharged. §§ 108(c)(2)(B), 1017(b)(3)(F)(iii).

Chapter 10

Compensation For Personal Injury and Sickness

Page 193: In *Blum v. Commissioner*, T.C. Memo. 2021-18, the taxpayer sought to exclude under § 104(a)(2) the $125,000 she received in settlement of a suit she had filed against the lawyers who had represented her in an unsuccessful personal injury lawsuit against a hospital. Notwithstanding the fact that the settlement agreement clearly indicated the taxpayer had not sustained any physical injuries as a result of the negligence of her attorneys, the taxpayer argued the settlement amount should be excluded because, but for her attorneys' negligence, she would have received damages from the hospital that would have been excludable under § 104(a)(2). The Tax Court rejected the taxpayer's argument, noting the settlement agreement made clear that the $125,000 paid to the taxpayer was not directly linked to any personal injuries but was instead compensation for legal malpractice "which plainly lies outside the scope of section 104(a)(2)."

Page 194: In PLR 201950004, the IRS ruled that physical, cognitive and behavioral injuries and disabilities suffered by an infant because of a clinic's failure to test for genetic mutations before implanting a donor egg and embryo in the taxpayer/birth mother could be characterized as physical injuries or physical sickness within the meaning of § 104(a)(2). As a result, the IRS concluded that the settlement received for these injuries and disabilities and the emotional distress attributable to them was excluded from taxpayer's income under § 104(a)(2) (other than those amounts reimbursing the taxpayer for medical expenses incurred and previously deducted).

Page 199 (Footnote 6): The last line of Footnote 6 should read: See Chapters 12 and 25.

Chapter 11

Fringe Benefits

Page 231: Note, as part of Qualified Transportation Fringe Benefits, that for 2022 the monthly limitation for qualified parking is $280, and the monthly aggregate fringe benefit exclusion for transportation in a commuter highway vehicle and any transit pass is $280. Rev. Proc. 2021-45, I.R.B. 2021-48.

Page 231 (Footnote 9): Add the following sentence to the end of Footnote 9:

> The Tax Cuts and Jobs Act of 2017, however, disallowed employers a deduction for the expense of any qualified transportation fringe benefit. § 274(a)(4). Final Regulations (T.D. 9939) have been issued interpreting and applying the limitations of both § 274(a)(4) and § 274(l).

Chapter 12

Business and Profit-Seeking Expenses

Page 254: In *Mylan v. Commissioner*, 156 T.C. No. 10 (2021), the court held that a generic drug manufacturer was entitled to deduct under § 162 legal costs incurred in defending patent infringement lawsuits related to its generic versions of some brand name drugs. Rejecting the Service's argument that these legal expenses constituted capital expenditures and thus were not currently deductible, the court concluded that the taxpayer incurred the legal expenses to protect its intellectual property and the business profits from that property. As a result, the court held that the expenses "arose out of the ordinary and necessary activities of [the taxpayer's] generic drug business and accordingly are deductible." [Chapter 14 of the casebook addresses the topic of capital expenditures in detail.]

Page 263: Footnote 3 notes the Tax Cuts and Jobs Act amendments to the § 162(m) limitation on remuneration paid by publicly held corporations to certain individuals. In December 2020, Treasury finalized regulations (T.D. 9932) interpreting and applying § 162(m) as amended.

Page 27: Insert the following at the end of the carryover paragraph:

In *Estate of Morgan v. Commissioner*, T.C. Memo 2021-104, a taxpayer whose homebuilding business was in receivership sought to deduct under § 162 certain aircraft expenses and the expenses associated with taxpayer's search for a new business opportunity. Noting that, under the receivership, all homebuilding activities had ceased, the court rejected taxpayer's argument that, by lending money to a friend and business partner to purchase some of the receivership properties, the taxpayer continued to carry on the homebuilding business. In addition, the court rejected the taxpayer' argument that his search for a new business opportunity satisfied the "carrying on any trade or business" requirement of §162. According to the court, the expenses taxpayer incurred with regard to the business search fit the definition of start-up expenditures in § 195(c)(1)(A)(i). As the court noted, the taxpayer "cannot squeeze into § 162 and avoid § 195 by claiming that [the taxpayer's] trade or business was searching for a trade or business."

Page 276 (Footnote 16): Footnote 16 should read: *See* Footnote 15.

Page 277: The IRS has posted on its website the following FAQ addressing the question raised in Footnote 20 on this page regarding whether § 162(q) precludes a victim of sexual harassment from deducting her attorney's fees if a settlement to which she is a party is subject to a nondisclosure agreement:

> ***Question:***
>
> *Does section 162(q) preclude me from deducting my attorney's fees related to the settlement of my sexual harassment claim if the settlement is subject to a nondisclosure agreement?*
>
> ***Answer:***
>
> *No, recipients of settlements or payments related to sexual harassment or sexual abuse, whose settlement or payment is subject to a nondisclosure agreement, are not precluded by section 162(q) from deducting attorney's fees related to the settlement or payment, if otherwise deductible....*

Page 279: Footnote 21 notes § 280E which disallows deductions or credits incurred by businesses trafficking in controlled substances. In *Northern California Small Business Assistants, Inc. v. Commissioner*, 153 T.C. 65 (2019), the Tax Court rejected taxpayer's arguments that: (1) § 280E doesn't apply to a marijuana business operated legally under state law; (2) § 280E is a penalty violating the Eighth Amendment of the U.S. Constitution; and (3) § 280E doesn't preclude taxpayer from claiming deductions under §§ 164 and 167. Previously, in *Alterman v. Commissioner*, T.C. Memo. 2018-83, the Tax Court applied § 280E to disallow deductions for expenses a medical marijuana business incurred with respect to the sale of "non-marijuana merchandise" (e.g., pipes, papers, and other items used to consume marijuana). In *Alterman*, the Tax Court held that the selling of the non-marijuana merchandise was not an activity separate from the taxpayer's business of selling marijuana merchandise but, instead, complemented that business. As a result, the court concluded the taxpayer was engaged in a single business, i.e., selling marijuana.

Page 280: In January 2021, Treasury issued final regulations (T.D. 9946) incorporating, interpreting, and applying the changes made by the Tax Cuts and Jobs Act to § 162(f). [Reg. § 1.162-21 (denial of deduction for certain fines, penalties, and other amounts); and Reg. § 1.6050X-1 (information reporting for fines, penalties, and other amounts by governments, governmental entities, and nongovernmental entities treated as governmental entities].

Page 280 (Footnote 24): Replace the text of Footnote 24 with the following text:

§ 162(f)(3). Additional important exceptions to the disallowance rule of § 162(f)(1) include: §162(f)(2) — the allowance of a deduction for certain amounts paid or incurred that constitute restitution (including remediation of property) or paid to come into compliance with the law; and § 162(f)(4) — the allowance of a deduction for "any amount paid or incurred as taxes due."

Chapter 13

Deduction for Qualified Business Income: Section 199A

Page 290: Add the following assignment: (Note the following regulations were finalized early in 2019.)

> **Treasury Regulations:** §§ 1.199A-1(b), (c)(1)-(3) Examples (1), (2) and (3), (d)(1),(2), (4) Examples (1) and (2), (5) and (6); 1.199A-2(a)(1)–(3), (b)(2), (c)(1)(i), (3)(i), (4) Example 1; 1.199A-5 (a), (b)(1), (b)(2)(xiv).

Page 292: In the fifth line of the paragraph headed *Net business income,* the citation should read § 199A(c)(1).

Page 293: Pursuant to Rev. Proc. 2021-45, I.R.B. 2021-48, the § 199A(e)(2) threshold amount for taxable years beginning in 2022 is $340,100 for married individuals filing joint returns, $170,050 for married individuals filing separate returns, and $170,050 for all other returns.

Page 294: In the sixteenth line of the first paragraph, the citation should read § 199A(d)(1).

Page 300: The parenthetical at the end of the Analysis of Example 6 should read as follows:

> (the lesser of Brenda's $32,500 combined qualified business income amount or $36,500 [20 percent the $182,500 excess of Brenda's taxable income of $182,500 over her net capital gain of $0]).

Chapter 14

Capital Expenditures

Page 320: After the last full paragraph insert the following:

In *Mylan, Inc. v. Commissioner*, 156 T.C. No. 10 (2021), discussed in Chapter 12 of this Supplement, the Tax Court held that the legal fees associated with obtaining FDA approval for medication must be capitalized as amounts paid to facilitate the acquisition or creation of an intangible.

Chapter 15

Depreciation

Note: For taxable years beginning after 2018, the dollar limitations of § 179(b)(1), (2) and (5)(A) are adjusted for inflation. §179(b)(6). [The 2022 inflation adjusted amounts are provided in Rev. Proc. 2021-45, I.R.B. 2021-48.] For the sake of simplicity, in answering the Problems in this Chapter, disregard the inflation adjustments. Thus, assume that the maximum deduction under § 179(a)(1) is $1,000,000.

Page 340: (Treasury Regulation Assignment) Add the following: Skim 1.168(k)-2(a)(1), (b)(1), (b)(3)(i)–(iii), (b)(4)(i), (e)(1)(i)(A), (e)(1)(ii), (e)(2)(i), (f)(1)(i), (g)(1)(i).

Page 346: The CARES Act amended § 168(e)(3)(E) to include "qualified improvement property" as "15-year property. " § 168(e)(3)(E)(vii). Qualified improvement property is "any improvement made by the taxpayer to an interior portion of a building that is nonresidential real property if such improvement is placed in service by the taxpayer after the date such building was first placed in service." § 168(e)(6)(A). The amendment to §168(e)(3)(E) renders qualified improvement property eligible for the additional first-year depreciation deduction allowed by § 168(k) discussed on pages 351-354. For purposes of the alternative depreciation system provided in § 168(g)(2), the CARES Act amended the table in § 168(g)(3)(B) to provide that qualified improvement property will have a class life of 20 years. § 168(g)(3)(B)(E)(vii).

Page 354: The last sentence of the Analysis of Example 2 states that Rennard's basis is reduced to $80,000. The sentence should state that Rennard's basis is reduced to $240,000.

Page 355: For taxable years beginning in 2022, under § 179 (b)(1), the aggregate cost of any § 179 property a taxpayer elects to treat as an expense cannot exceed $1,080,000 and, under § 179 (b)(5)(A), the cost of any sport utility vehicle that may be taken into account under § 179 cannot exceed $27,000. As adjusted for inflation, the $1,080,000 limitation of § 179 (b)(1) is reduced (but not below zero) by the amount the cost of § 179 property placed in service during the 2022 taxable year exceeds $2,700,000. Rev. Proc. 2021-45, I.R.B. 2021-48.

Page 382: The Year 1 depreciation percentage in Table A-7a is incorrect for all months except Month 1. The correct amounts for all months are shown in the table below:

Table A-7a: Nonresidential Real Property
Mid-Month Convention
Straight Line — 39 Years

Month Placed in Service	Year 1	Year 2–39	Year 40
1	2.461%	2.564%	0.107%
2	2.247%	2.564%	0.321%
3	2.033%	2.564%	0.535%
4	1.819%	2.564%	0.749%
5	1.605%	2.564%	0.963%
6	1.391%	2.564%	1.177%
7	1.177%	2.564%	1.391%
8	0.963%	2.564%	1.605%
9	0.749%	2.564%	1.819%
10	0.535%	2.564%	2.033%
11	0.321%	2.564%	2.247%
12	0.107%	2.564%	2.461%

Chapter 16

Losses and Bad Debts

Page 390: The references to "Reg. § 1.165-9(a)(2)" should be corrected to read "Reg. § 1.165-9(b)(2)"

Page 390: In Footnote 1, delete the extra zero so that depreciation deductions are $5,400.

Page 393: In *VHC Inc. v. Commissioner*, 968 F.3d 839 (7th Cir. 2020), the court concluded that a taxpayer (a family-owned business) was not entitled to either a bad debt deduction under § 166 or a business deduction under § 162 with respect to $92 million dollars of advances it had made to the son of the founder of the business. With regard to the bad debt deduction, the court held the taxpayer failed to establish the existence of a debtor-creditor relationship between the taxpayer and the founder's son. Although the son had signed promissory notes, many of those notes had no fixed maturity dates, the taxpayer routinely deferred note payments or renewed the notes, and there was no expectation of repayment of the notes unless certain events occurred. Given these facts, the court concluded the taxpayer was more like an investor rather than a creditor. With respect to its claim that, pursuant to § 162, it could deduct the amount advanced to the founder's son, the taxpayer relied on the fact that a bank (a creditor of both the taxpayer and the founder's son) had threatened to terminate the taxpayer's line of credit if it did not advance money to the founder's son. The court concluded that, even if the advances were established to be necessary, the taxpayer had made no showing that such advances ordinarily occur in the industry in which taxpayer was engaged. As a result, the court rejected taxpayer's claim to a § 162 business deduction.

Chapter 17

Travel Expenses and Business Meals

Page 414: Following the excerpt from *Commissioner v. Flowers*, insert the following:

The U.S. Court of Appeals for the D.C. Circuit has affirmed the Tax Court's decision in *Liljeberg v. Commissioner*. 2018 U.S. App. LEXIS 31067. At issue in *Liljeberg* were deductions for living and travel expenses claimed by three foreign nationals who participated in the State Department's Summer Work Travel Program. (The Summer Work Program provides "'foreign students who are enrolled full-time and pursuing studies at accredited post-secondary academic institutions . . . with the opportunity to work and travel in the United States' for a period of up to four months, during their summer vacations." 22 C.F.R. § 62.32(b), (c). Note the year at issue in the case preceded the enactment of § 67(g).) Income earned in the Summer Work Program is subject to federal income taxes. § 871(b)(1), (c). In affirming the Tax Court, the D.C. Circuit Court concluded the taxpayers had failed to establish that their living and travel expenses were "in pursuit of a trade or business," i.e., they failed to establish the necessary relationship between their expenditures and the employer's business. In other words, the taxpayers failed to satisfy the business exigency test enunciated as follows in *Commissioner v. Flowers*, 326 U.S. 465, 470, a 472:

> Travel expenses in pursuit of business within the meaning of [now § 162(a)(2)] could arise only when the [employer's] business forced the taxpayer to travel and to live temporarily at some place other than [his usual residence], thereby advancing the interests of the [employer]. Business trips are to be identified in relation to business demands and the traveler's business headquarters. The exigencies of business rather than the personal conveniences and necessities of the traveler must be the motivating factors

The court noted that the taxpayers' temporary employers did not require the taxpayers to move to the United States. Instead, the taxpayers chose to come to the United States to participate in the Summer Work Travel Program. Their living and travel expenses were thus the product of their own choice rather than the needs of were required to have a "J visa" (which is issued to "an alien having a residence in a foreign country which [the person] has no intention of abandoning," 8 U.S.C. §

1101(a)(15)(J)), established that they maintained a home for business purposes in their own countries, and were traveling away from that home for business purposes. The court concluded by noting:

> Allowing foreign students who travel to the United States on a "J visa" for temporary employment to deduct their travel expenses when students who are U.S. citizens traveling within the United States to seek temporary employment cannot, *see Weiberg v. Commissioner*, 639 F.2d 434, 437 (8th Cir. 1981), would be a peculiar and irrational result.

Page 418: In *Geiman v. Commissioner*, T.C. Memo 2021-80, the Tax Court, rejecting the Service's argument that a taxpayer, a union electrician, was an itinerant with no tax home, concluded that the taxpayer, who during the tax year had a series of temporary jobs in Wyoming and Colorado, did not have a principal place of business but did have a tax home. Specifically, the court found that Clifton, Colorado, the town where Geiman had resided since 2007 was his tax home. Consequently, Geiman was away from home for purposes of § 162(a)(2) when he traveled from Clifton to the various temporary job sites and was therefore entitled to deduct certain travel expenses.

The court's conclusion that Geiman had a tax home in Clifton was based on its application of the three-pronged analysis of Rev. Rul. 73-529, 1973-2 C.B. 37 — i.e., whether "(1) the taxpayer incurs duplicate living expenses while traveling and maintaining the home, (2) has personal and historical connections to the home, and (3) has a business justification for maintaining the home." As the court stated:

> First, the record shows that Mr. Geiman incurred substantial continuous living expenses [in Clifton] in the form of mortgage payments, as evidenced by both his 2013 tax return on which he claimed the home mortgage interest deduction and his monthly credit card statements showing mortgage payments. Second, Mr. Geiman had significant personal and historical ties to Clifton, persuasively testifying at trial that he had been a resident at least since 2007 and that his nonwork life was firmly centered there.
>
> Finally, Mr. Geiman's relationship with his home local union gives him an adequate business justification for making his home in Clifton.... We have previously identified a taxpayer's membership in and continued contacts with a local union as a business justification for maintaining a tax home

away from temporary jobs.... Mr. Geiman testified convincingly how important it is for a union member to be faithful and to have a continuous membership in a home local. In addition to job referrals near or far, he explained that fidelity to one's home local stands a person in good stead among union peers who are critical to learning about and obtaining union jobs. Mr. Geiman's home local also had been a direct source of a job in Grand Junction [Colorado] as recently as December 2012, distinguishing this case from others in which a taxpayer had little hope of finding employment near his residence.

Page 424: At the end of the carryover paragraph, add the following:

Finally, as a result of the Consolidated Appropriations Act, 2021, the 50-percent limitation does not apply for 2021 and 2022 to "food and beverages provided by a restaurant … paid or incurred before January 1, 2023." §274(n)(2)(D), as added by the Consolidated Appropriations Act, 2021. In effect, for 2021 and 2022, there is a 100-percent deduction for business meal food or beverages "provided by a restaurant," which clearly encompasses not only food or beverages consumed on the restaurant's premises, but carry-out or delivery meals from the restaurant. (In some circumstances, the definition of "restaurant" may be critical to the application of the 100-percent deduction.)

As discussed in Chapter 12, the 2017 tax legislation eliminated the deduction for entertainment expenses. That legislation, however, did not address the circumstances in which the provision of food and beverages might constitute entertainment, but the legislative history of the Act clarified that taxpayers generally may continue to deduct 50 percent of the food and beverages associated with operating their trade or business — or, indeed, 100 percent for 2021 and 2022 if the foregoing exception for restaurant-provided food and beverages applies. The initial guidance on this matter was provided by the Service in Notice 2018-76, 2018-42 I.R.B. 599, which provided that taxpayers may deduct 50 percent [again, potentially 100 percent for 2021 and 2022] of an otherwise allowable business meal expense if the following five conditions are satisfied:

1. The expense is an ordinary and necessary expense under § 162(a) paid or incurred during the taxable year in carrying on any trade or business;

2. The expense is not lavish or extravagant under the circumstances;

3. The taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages;
4. The food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and

5. In the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. The entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages.

Final regulations have now been issued dealing with the elimination of the entertainment deduction and the determination of which activities are of a type generally considered to be entertainment.[1] The regulations largely incorporate the guidance of Notice 2018-76 in this regard, but they also, among other matters, (1) apply that guidance to all food and beverages provided at or during entertainment activities, (2) provide important clarification on the requirement that the disallowance of the entertainment deduction may not be circumvented by overcharging for food and beverages, and (3) define the term "current or potential business contact" — that is, define the category of persons to whom the taxpayer may provide the deductible food and beverages.

The regulations provide the following helpful examples (which are similar to the examples in the Notice) illustrating the difference between nondeductible entertainment expenses and deductible business meals. In each example, neither the taxpayer nor the business associate is engaged in a trade or business that relates to the entertainment activity.

Example 1. Taxpayer A invites B, a business associate, to a baseball game to discuss a proposed business deal. A purchases tickets for A and B to attend the game. The baseball game is entertainment as defined in Reg. § 1.274-11(b)(1) and thus, the cost of the game tickets is an entertainment expense and is not deductible by A.

1

TD 9925 (2020). The regulations also address the section 274(n) and (k) limitations on deductibility.

> **Example 2.** Assume the same facts as [Example 1] except that A also buys hot dogs and drinks for A and B from a concession stand. The cost of the hot dogs and drinks, which are purchased separately from the game tickets, is not an entertainment expenditure and is not subject to disallowance under Reg. §1.274-11(a) and § 274(a)(1). Therefore, A may deduct 50 percent of the expenses associated with the hot dogs and drinks purchased at the game if they meet the requirements of § 162 and Reg. § 1.274-12 [which requires that the expenses not be lavish or extravagant under the circumstances; the taxpayer or taxpayer's employee is present at the furnishing of the food and beverages; and the food and beverages are provided to a business associate].
>
> **Example 3.** Taxpayer C invites D, a business associate, to a basketball game. C purchases tickets for C and D to attend the game in a suite, where they have access to food and beverages. The cost of the basketball game tickets, as stated on the invoice, includes the food and beverages. The basketball game is entertainment as defined in Reg. § 1.274-11(b)(1) and, thus, the cost of the game tickets is an entertainment expense and is not deductible by C. The cost of the food and beverages, which are not purchased separately from the game tickets, is not stated separately on the invoice. Thus, the cost of the food and beverages also is an entertainment expense that is subject to the § 274(a)(1) disallowance. Therefore, C may not deduct the cost of the tickets or the food and beverages associated with the basketball game.
>
> **Example 4.** Assume the same facts as [Example 3], except that the invoice for the basketball game tickets separately states the cost of the food and beverages and reflects the venue's usual selling price if purchased separately. As in [Example 3], the basketball game is entertainment as defined in Reg. § 1.274-11(b)(1) and, thus, the cost of the game tickets, other than the cost of the food and beverages, is an entertainment expense and is not deductible by C. However, the cost of the food and beverages, which is stated separately on the invoice for the game tickets, is not an entertainment expense and is not subject to the § 274(a)(1) disallowance. Therefore, C may deduct 50 percent of the expenses associated with the food and beverages provided at the game if they meet the requirements of section 162 and Reg. § 1.274-12.

Again, note for 2021 and 2022 the potential for 100 percent deductibility instead of 50 percent for food and beverages "provided by a restaurant."

Chapter 18

Education Expenses

Pages 471-475: The casebook on these pages refers to the Hope Scholarship Credit. That credit was renamed the American Opportunity Tax Credit.

Pages 472-473: For taxable years beginning after December 31, 2020, the Consolidated Appropriations Act, 2021 repealed § 222 (qualified tuition deduction). The Act replaces that deduction by increasing the phase out limits on the Lifetime Learning Credit. The increased credit is provided in a new provision, § 25A(d)(1) which replaces former § 25A(d)(1) and (2). Newly enacted § 25A(d)(1) provides as follows:

(1) IN GENERAL.—The American Opportunity Tax Credit and the Lifetime Learning Credit shall each (determined without regard to this paragraph) be reduced (but not below zero) by the amount which bears the same ratio to each such credit (as so determined) as—

(A) the excess of—

(i) the taxpayer's modified adjusted gross income for such taxable year, over

(ii) $80,000 ($160,000 in the case of a joint return), bears to

(B) $10,000 ($20,000 in the case of a joint return).

(2) CONFORMING AMENDMENT.—Section 25A is amended by striking subsection (h).

...

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2020.

Pages 474-475: The Further Consolidated Appropriations Act, 2020 amended § 529(c) to add a new paragraph (9) which expands the definition of "qualified higher education expense" to include amounts (not to exceed $10,000) "paid as principal or interest on any qualified education loan (as defined in section 221(d)) of the designated beneficiary or a sibling of the designated beneficiary."

Page 475: Pursuant to the CARES Act, as amended by the Consolidated Appropriations Act, 2021, for the years 2020 through 2025, “educational assistance” eligible for exclusion from an employee’s income under § 127 includes an employer’s payment of principal or interest on an employee’s qualified education loan. § 127(c)(1)(B), as amended.

Chapter 19

Dual Use Property: Home Offices, Vacation Homes, and Passenger Automobiles

Pages 491-92: Delete Example 3 and Example 4 and insert the following immediately before Example 3:

Special issues arise when the purchase price of the automobile exceeds the first-year dollar limitation of §§ 280F(a)(1)(A)(i) and 168(k)(2)(F)(i). In that case, when the 100-percent additional first year depreciation deduction allowable under § 168(k)(1) exceeds the first-year limitation amount, Rev. Proc 2019-13, I.R.B. takes the position that the excess amount is a "disallowed deduction" for purposes of § 280F(a)(1)(B). As such, *the excess amount is not deductible until the first year after the end of the recovery period, and then only to the extent of the annual limitation under § 280F(a)(1)(B)(ii).* Revenue Procedure 2019-13 illustrates this point, with respect to the year 2018 and a dollar limitation of $18,000, with an example where the cost of the automobile is $50,000. The $32,000 excess ($50,000 less $18,000) is a disallowed deduction. As such, it cannot be deducted to any extent until 2024 (the first year after the end of the 2018-2023 recovery period) and then only at the rate of $5,760 per year, the annual limitation under § 280F(a)(1)(B)(ii) for years after the recovery period.

In the words of the revenue procedure, "to mitigate [the] anomalous result" under which no deduction at all is allowable for Years 2 through 6 (2019 through 2023) of the recovery period, Rev. Proc. 2019-13 provides a safe harbor method of accounting that permits such deductions. The safe harbor is applicable only (1) where the automobile is qualified property for which the 100-percent additional first year depreciation deduction is allowable; (2) the cost of the automobile exceeds the first year limitation of § 280F(a)(1)(A); and (3) the taxpayer does not elect any deduction under § 179. If these requirements are met, the remaining depreciable basis may be recovered by applying to that basis the applicable depreciation rates (found in the depreciation tables) for Years 2 through 6, subject to the annual limitation of § 280F(a)(1)(A). The safe harbor is illustrated in Example 3 below.

Example 3: Assume the facts of Example 1, except that the purchase price of the automobile is $40,000. As indicated in Example 1, the Year 1 depreciation limitation is $18,000. Marilyn may deduct no more than that under § 168(k)(1) or § 179, and she may take no additional deduction under § 168(a). If Marilyn deducts the $18,000 under § 168(k)(1), Rev. Proc. 2019-13 will allow her to deduct the remaining $22,000 of unrecovered basis in Years 2 through 6, and thereafter, subject to the year-by-year limitations of § 280F(a)(1)(A), under the safe harbor method.[2] However, if Marilyn elects out of § 168(k)(1) and deducts the $18,000 under § 179, the safe harbor method is not available, and the remaining $22,000 is treated as a disallowed deduction under § 280F(a)(1)(B); as a result, no further depreciation deductions are allowed for the remainder of the recovery period, and when further recover is permitted in Year 7, it is limited to the annual maximum of $5,760 under § 280F(a)(1)(B)(ii). Finally, if Marilyn elects out of § 168(k)(1) and does not elect § 179, and instead takes her depreciation deductions under § 168(a)(1), her Year 1 deduction will be 20 percent of $40,000, or $8,000, an amount within the Year 1 limit of § 280F(a)(1)(A).[3]

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[2] Pursuant to the depreciation tables for 5-year property, applying the 200-percent declining balance method, the depreciation deductions after Year 1 are as follows: Year 2 — $7,040 (the remaining unrecovered basis of $22,000 times 32 percent); Year 3 — $4,224 ($22,000 times 19.2 percent); Year 4 — $2,534.40 ($22,000 times 11.52 percent); Year 5 — $2,534.40 ($22,000 times 11.52 percent); and Year 6 — $1,267.20 ($22,000 times 5.76 percent). Note, in each year, the depreciation deduction is within the annual dollar limitations of § 280F(a)(1)(A). Also note the aggregate depreciation deductions for Year 1 through Year 6 total $35,600. The remaining $4,400 of the $40,000 purchase price will not be recovered until Year 7; it is within the annual dollar limitation.

[3] Accordingly, there is no disallowed deduction for purposes of § 280F(a)(1)(B)(i). The safe harbor method, although not available, is also not necessary, as Marilyn may deduct the remaining basis $32,000 of unrecovered basis pursuant to the applicable depreciation rates for 5-year property for Years 2 through 6; note the dollar amounts in each of those years will be within the year-by-year limitations of § 280F(a)(1)(A), and thus there will be no disallowed deduction for purposes of § 280F(a)(1)(B).

Example 4: Assume the facts of Example 3, except that Marilyn's business use of the automobile is 75 percent rather than 100 percent. Because her business use satisfies the more-than-50-percent standard, Marilyn is allowed to calculate the depreciation deduction under an accelerated method rather than under straight-line. Assuming she does so under § 168(k)(1), she may deduct 75 percent (her business use percentage) of $18,000 (the maximum Year 1 deduction), or $13,500. However, the adjusted basis of the automobile, as in Example 2, must be reduced by the full $18,000 of depreciation attributable to the aggregate of her nondeductible personal use and deductible business use. (She may presumably continue to take depreciation deductions in Years 2 through 6 of the recovery period, and thereafter, under the safe harbor method authorized by Rev. Proc. 2019-13, subject to the § 280F(a)(1)(A) limits. If she were to elect out of § 168(k)(1), however, and made a § 179 election, she would have the same Year 1 deduction of $13,500 as under § 168(k)(1) and the same reduction in basis of $18,000. However, as noted in Example 3, the remaining unrecovered basis would be treated as a disallowed deduction under § 280F(a)(1)(B)(i), and no further deductions would be permitted during Years 2 through 6 of the recovery period. If, alternatively, Marilyn chose to elect out of § 168(k)(1), and did not elect § 179, but instead chose to determine the depreciation deduction under § 168(a) only, the deduction would be 75 percent of $8,000 (20 percent of the $40,000 unadjusted basis) or $6,000. The unrecovered basis would be $32,000 ($40,000 less $8,000), deductible during Years 2 through 6 of the recovery period and thereafter subject to the § 280F(a)(1)(A) limits.

Chapter 20

The Interest Deduction

Page 500: The last line in the opening paragraph should refer to Chapter 25 instead of Chapter 27.

Page 501 (Footnote 2): The citation in Footnote 2 should be § 163(h)(2)(A).

Page 503: Because the home mortgage interest deduction is an itemized deduction, i.e., a below-the-line deduction, the significant increase in the standard deduction provided by the Tax Cuts and Jobs Act of 2017 has resulted in fewer taxpayers itemizing and, in turn, few taxpayers claiming the home mortgage interest deduction.

Page 509: Add the following sentence to the last line of the second paragraph: The $25 million is adjusted for inflation.

Chapter 21

The Deduction for Taxes

Page 524: After the first paragraph, insert the following:

In response to the $10,000 limitation, a number of states adopted or considered "workaround" strategies under which, by making contributions to designated state or local charities — contributions intended to be deductible under § 170 for federal income tax purposes and thus not subject to a $10,000 cap — a taxpayer would receive a state or local tax credit against state income taxes otherwise due. As a result, for federal tax purposes, nondeductible state taxes (nondeductible by reason of exceeding the $10,000 limit) could be converted to deductible charitable contributions while the taxpayer continued to receive a state or local income tax credit for the same payment.

Under regulations finalized in 2019, this strategy is largely blocked. The general rule of the regulations is that taxpayers must reduce the amount of their charitable contribution by the amount of any state or local tax credit received in consideration for the taxpayer's payment to the state or local charity. Reg. § 1.170A-1(b)(3)(i).

> **Example 1:** Susan pays $1,000 to State Charity, an entity described in § 170(c), and thus for which a federal charitable contribution is allowable. In return for her payment, Susan receives a state tax credit equal to 60 percent of her payment, or $600. Susan's charitable contribution, for federal tax purposes, is reduced by the $600 state credit she receives. The amount of her charitable contribution, for federal tax purposes, is $400 ($1,000 payment less $600 credit).

The regulations provide an exception under which no reduction in the charitable contribution is required if the state or local tax credit does not exceed 15 percent of the taxpayer's payment. Reg. § 1.170A-1(h)(3)(vi).

> **Example 2**: Assume the facts of Example 1, except that the state tax credit Susan receives is equal to 15 percent of her payment, or $150. Because the credit does not exceed 15 percent of her payment, Susan is not required to reduce her $1,000 charitable contribution for federal tax purposes.

The regulations provide another exception for so-called dollar-for-dollar state or local tax *deductions*. If, in return for the payment to a qualifying charitable organization, a taxpayer receives state or local tax deductions that do not exceed the amount of the taxpayer's payment, no reduction is required in the amount of the taxpayer's federal charitable contribution. Reg. § 1.170A-1(h)(3)(ii)(A).

> **Example 3:** Assume the facts of Example1, except that in return for her payment of $1,000, Susan receives a $1,000 deduction for state tax purposes. Because the state deduction does not exceed the amount of the payment, Susan is not required to reduce her $1,000 charitable contribution for federal tax purposes.

Finally, the Service issued (contemporaneously with the final regulations) Notice 2019-12, I.R.B. 2019-27. The notice provided a safe harbor under which a taxpayer who itemizes deductions for federal tax purposes may deduct the *disallowed portion* of the charitable contribution as a payment of state or local tax for federal tax purposes.

Regulations incorporating this safe harbor have now been issued. Reg. § 1.164-3(j). The safe harbor, however, cannot be used to avoid the limitation of § 164(b)(6) or to permit the same payment to be deducted under any other provision of the Code. Reg. § 1.164-3(j)(3), (5).

> **Example 4:** Assume the facts of Example 1, pursuant to which Susan's $1,000 payment to State Charity was reduced to $400 (for federal charitable contribution purposes) on account of the 60 percent state tax credit. Under the safe harbor rule of Reg. § 1.164-3(j), Susan may treat $600 (the disallowed portion of the charitable contribution) as a payment of her state or local tax liability for purposes of § 164. Susan's deduction of that amount is subject to all provisions of § 164, including the § 164(b)(6) limitation. See Reg. § 1.164-3(j)(6), Ex. 3.

Chapter 22

Casualty Losses

Note: The number of returns claiming the casualty loss deduction has been reduced largely due to the significant increase in the standard deduction provided by the Tax Cuts and Jobs Act of 2017 which resulted in fewer taxpayers itemizing deductions.

Page 531: Assume all losses identified in the various questions of Problem 1 are sustained by the taxpayer between 2018 and 2025.

Page 532: Assume all of the gains and losses identified in Problem 3 were computed by reference to the basis Rose had in the properties noted.

Page 538: In *Mancini v. Commissioner*, T.C. Memo. 2019-16, taxpayer claimed a deduction under § 165(c)(3) for large gambling losses resulting from his compulsive gambling which he attributed to a medication he was taking for Parkinson's disease. According to the taxpayer, the medication caused an impulse control disorder (ICD) which, in turn, resulted in his compulsive gambling. The taxpayer argued that the ICD fits the definition of "other casualty" under § 165(c)(3) — the ICD "was sudden because it manifested abruptly once his dosage [of the medication] reached a certain level, it was unexpected because neither he nor [his doctor] anticipated it, and it was unusual, even for [other takers of the medication]." Although the court agreed the medication could cause compulsive gambling and likely did so in the taxpayer's case, the court nonetheless concluded the taxpayer's gambling losses were not deductible as casualty losses under § 165(c)(3) because the taxpayer could not establish any physical damage and the losses were not "sudden."

In rejecting the taxpayer's argument that physical damage was not required, the court reviewed the long history of case law requiring a showing of physical damage: "We do find that Mancini's brain was damaged by the [medication], but physical damage to property remains one of the prerequisites of a casualty-loss deduction. Mancini's depleted bank accounts ... didn't suffer any physical damage. So, even if the onset of his ICD was sudden, unexpected, and unusual, Mancini isn't entitled to a section 165(c)(3) deduction for his gambling losses."

In addition to the failure to establish any physical damage, the court held a deduction under § 165(c)(3) was also unavailable as the taxpayer's losses were not "sudden" and therefore did not qualify as a casualty losses within the meaning of § 165(c)(3):

> Mancini claims he suffered gambling losses over the course of three years. These losses were necessarily the result of dozens or hundreds of individual gambling sessions and probably thousands of separate wagers.... [A] three-year-long casualty is not "sudden." A revenue ruling summarizing caselaw tells us that "sudden" means "swift and precipitous and not gradual and progressive." Rev. Rul. 72-592, 1972-2 C.B. at 101. Even if the onset of the ICD was "sudden," and even if Mancini didn't realize what was happening to his savings until three years later, the gambling losses grew gradually over time--Mancini himself is trying to deduct compulsive-gambling losses for three separate tax years. That makes the losses he sustained just like damage from slow-moving termites or dry rot, which can start without the taxpayer's knowledge and take years to discover, but isn't a casualty because the damage is not sudden.
>
> Mancini's losses are simply not what the Code considers a "casualty". They progressed over the course of three years, and there was no physical damage to any of his property. Section 165(c)(3) allows the deduction of only specific types of losses--it's not a stand-in for all the types of damages that would be recoverable in a civil action.

Page 539: In *Bruno v. Commissioner*, T.C. Memo 2020-15, the Tax Court questioned whether a taxpayer could establish that her ex-husband's refusal to transfer to her certain marital property as ordered by a divorce court constituted a theft. Even assuming, however, that the refusal did constitute theft, the court concluded the theft loss would not be deductible because the taxpayer had "bona fide claims for recoupment" and "a substantial possibility" existed that she would prevail on those claims.

Chapter 23

Medical Expenses

Statutory Update: Page 554 and Footnote 1: Under the Consolidated Appropriations Act, 2021, the 10-percent nondeductible floor has been reduced permanently, and not merely year-by-year, to 7.5 percent for 2021 and thereafter. Thus, uncompensated medical expenses of the taxpayer, spouse and dependents are deductible under § 213 to the extent they exceed 7.5 percent of the taxpayer's adjusted gross income. § 213(a) as amended and § 213(f) as deleted by the Consolidated Appropriations Act, 2021.

For purposes of the Problem, assume the tax year is 2022 and thus the taxpayers' medical care expenses are deductible to the extent they exceed 7.5% of the taxpayers' adjusted gross income.

Page 555 and Footnote 2: The first full paragraph and Footnote 2 note that, for purposes of the § 213 deduction, qualifying medicine and drugs are limited to those that legally require a prescription. § 213(b). Footnote 2, however, points out that, for purposes of § 105(b) (employer reimbursements of employee medical care expenses), there was no prescription requirement for medicine and drugs, at least at the time of the cited 2003 revenue ruling. Beyond the individual deduction of § 213, the Code in fact provides several other tax-favored medical care arrangements, each with its own requirements. Thus, employer reimbursements of employee medical care expenses may be excluded from gross income under flexible spending accounts or health reimbursement accounts. §§ 105(b), 125. Health savings accounts, authorized by § 223, allow for savings and payments for medical expenses on a tax-favored basis, as do Archer Medical Savings Accounts authorized by § 220. Between 2010, with the enactment of the Patient Protection and Affordable Care Act, and 2020, qualifying medicines and drugs were limited, as under § 213(b), to those requiring a prescription. See §§ 106(f), 220(d)(2)(A), 223(d)(2), as before amendment by the 2020 CARES Act. The CARES Act amends these three cited statutes to eliminate the prescription requirement for medicine and drugs provided thereunder, thus restoring the pre-2010 law on medicine and drugs described in Rev. Rul. 2003-102 in Footnote 2. The CARES Act also extends the definition of qualified medical expenses applicable to these three cited statutes — but not to § 213 — to include menstrual care products.

Chapter 24

Charitable Deductions

Pages 563–564: In Problems 2 and 3, assume the contributions were made in 2022 unless your instructor directs otherwise.

Page 566 (Footnote 2): Footnote 2 raises a question regarding the impact of the increased standard deduction on charitable giving. Not surprisingly, Treasury statistics indicate a dramatic reduction in the number of returns claiming a deduction for charitable contributions. Nonetheless, it appears the overall amount of charitable giving has not been significantly affected.

Page 568: As noted in Chapter 21, § 164(b)(6) [added by the Tax Cuts and Jobs Act of 2017] imposes a $10,000 limit ($5,000 in the case of a married individual filing a separate return) on an individual's deduction for the aggregate amount of state and local taxes paid during the taxable year. Section 164(b)(6) provides that this limitation is not applicable to taxes incurred in carrying on a trade or business or a § 212 activity. As discussed in Chapter 21 of this Supplement, states and local governments have for a number of years offered tax credit programs providing taxpayers tax credits for making contributions to or for the use of certain entities described in § 170(c). Given the lack of any dollar limitation on the amount of state and local taxes deductible under §164, these programs were of little significance for federal tax purposes. With the enactment of the limitations under § 164(b)(6) and the significant increase in efforts by state and local governments to devise alternate means for taxpayers to deduct the disallowed portion of their state and local taxes, Treasury, as a matter of tax policy, concluded action needed to be taken "to prevent revenue loss from the erosion of the limitation under § 164(b)(6)." TD 9864, 84 FR 27513. To that end, Treasury in June 2019 issued final regulations — Reg. § 1.170A-1(h)(3) — providing "that if a taxpayer makes a payment or transfers property to or for the use of an entity listed in section 170(c), and the taxpayer receives or expects to receive a state or local tax credit in return for such payment, the tax credit constitutes a return benefit, or *quid pro quo,* to the taxpayer and reduces the taxpayer's charitable contribution deduction." Id. See Reg. § 1.170A-1(h)(3)(i). An exception is made for *state and local tax credits* received in exchange for a contribution where the credits don't exceed 15 percent of the amount contributed. Reg. § 1.170A-1(h)(3)(vi). In addition, a taxpayer is

generally not required to reduce its charitable deduction as a result of the receipt of a state or local tax *deduction*. Reg. § 1.170A-1(h)(3)(ii)(A). See the examples provided in Chapter 21 of this supplement.

The final regulations noted above did not address certain ancillary issues including the application of the *quid pro quo principle* of § 170 to benefits received or expected to be received by the donor from a party *other than the donee*. In August 2020, Treasury finalized regulations under §170 to provide that the *quid pro quo* principle also applies in this context. Reg. § 1.170A-1(h)(4).

Chapter 27

Accrual Method Accounting

Page 669: Delete the assignment to skim Treas. Reg.§ 1.451-5.

Page 677: After the second full paragraph, add the following:

Regulations recently issued under § 451(b) and (c) reflect the recognition that the underlying statutes themselves are in substance a codification of Rev. Proc. 2004-34. The § 451(b) regulations make clear that the so-called "AFS inclusion rule" — that is, the statutory requirement that a taxpayer with an applicable financial statement (AFS) include an amount in income no later than its inclusion in the taxpayer's AFS — operates only to accelerate income inclusion, never to postpone income beyond the point the all events test is satisfied. Similarly, the § 451(c) regulations make clear that advance payments may be deferred not only by taxpayers with an AFS, but also by taxpayers without an AFS, in which case the taxpayer electing deferral includes the advance payment as earned in the year of receipt. As always, any part of an advance payment not included in income in the year of receipt must be included in income in the following year.

Page 678, **first full paragraph:** Following the 2017 enactments of new § 451(b) and (c), making advance payment treatment applicable to the sale of goods, Treas. Reg. § 1.451-5 was deleted by regulations issued in October, 2019. Accordingly, the reference to that provision in the first full paragraph on this page should be deleted.

Page 678: Following the last full paragraph, insert the following:

In *RJ Channels, Inc. v. Commissioner*, T.C. Memo. 2018-27, the Tax Court addressed the timing of fees received by an accrual method taxpayer for tax services provided. The taxpayer was under an obligation to return the fees to the clients if the taxpayer did not achieve a favorable result for them. The taxpayer deposited the fees in its bank account, was unrestricted in the use of the fees, periodically made withdrawals from its bank account for its own purposes, and ultimately never returned the fees to the clients. The Tax Court held the fees were includable in the taxpayer's gross income in the year of receipt rather than deferred until some later year as taxpayer contended. The court noted that "[i]n applying the

all events test, this and other courts have distinguished between conditions precedent, which must occur before the right to income arises, and conditions subsequent, the occurrence of which will terminate an existing right to income, but the presence of which does not preclude accrual of income." The court found that the obligation to return the fees was a condition subsequent and, consistent with accrual principles as well as the claim of right doctrine (discussed in Chapter 3), the taxpayer was required to include the fees in gross income upon receipt.

Page 688: Treasury has finalized regulations (T.D. 9942) addressing legislative changes to § 448.

Chapter 28

Annual Accounting

Page 715: As discussed previously, miscellaneous itemized deductions as defined in § 67(b) are subject to limitations, including disallowance under § 67(g) for the taxable years beginning after December 31, 2017 and before January 1, 2026. Section 67(b)(9), however, excludes from the § 67(b) definition of "miscellaneous itemized deductions" the deduction under § 1341. A taxpayer repaying income received under a claim of right will be allowed a deduction under § 1341 only if the taxpayer can establish that she would be entitled to a deduction for the repayment under **another** provision of the Code. § 1341(a)(2) and (3). For example, an employee required to return income (compensation for services) previously included by the employee in income under a claim of right would rely on § 162 as authority for a deduction. Because the repayment was incurred in the trade or business of being an employee, the § 162 deduction would be a below-the-line deduction. See § 62(a)(1). Disregarding § 67(b)(9), that deduction would be a miscellaneous itemized deduction as defined by § 67(b). Query: Does § 67(g) negate the application of § 67(b)(9) in the employee's circumstances thus depriving the employee of the benefit of § 1341? Your authors believe the answer is "No." Just as § 67(b)(9) was intended to free the taxpayer of the 2% "haircut" of § 67(a), we believe that, to be consistent with Congress' purpose in enacting § 1341, § 67(b)(9) must be interpreted as likewise freeing the taxpayer of the disallowance rule of § 67(g).

Pages 718-719: The CARES Act suspended the application of the 80 percent limitation of § 172(a)(2) for taxable years beginning after December 31, 2017 and before January 1, 2021. § 172(a)(1). Thus, for those taxable years, the net operating loss deduction will be the aggregate of the net operating carryovers and net loss carrybacks to those years.

For a taxable year beginning after December 31, 2020, § 172(a)(2) provides the net operating loss deduction will equal the sum of:

> (A) the aggregate amount of net operating loss carryovers to that year from net operating losses arising in taxable years beginning before January 1, 2018 plus
> (B) the lesser of —

(i) the aggregate amount of net operating loss carryovers to that year from net operating losses arising in taxable years beginning after December 31, 2017, or

(ii) 80 percent of the excess (if any) of —

(I) the taxable income for the year computed without regard to deductions under §§ 172, 199A and 250 over

(II) the amount determined under (A) above.

Accordingly, assume that Year 1 in the Example on page 719 is 2022.

Chapter 29

Capital Gains and Losses

Page 738: Assume in answering the Part B Problems that the rates and brackets applicable to Henry and Nancy as a married couple filing a joint return are as follows (these are the 2018 rates and brackets):

If taxable income is:	The tax is:
Not over $19,050	10% of taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000	$8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000	$28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600

Further assume (also based on 2018 amounts) Henry and Nancy's Maximum Zero Rate Amount is $77,200 and their Maximum 15-Percent Rate Amount is $479,000.

Page 748: After the last sentence of the second paragraph, add the following sentence: "The 20 percent rate on adjusted net capital gain will also apply to a taxpayer in the 35 percent marginal income tax bracket if the taxpayer's taxable income is above the '20 percent breakpoint' — that is, the specific dollar amount in the 35 percent tax bracket (a dollar amount adjusted for inflation) at which the 15 percent rate on adjusted net capital gain becomes a 20 percent rate."

Page 750: After the second sentence in the first full paragraph, delete the third sentence and insert in its place the following sentence: "For taxpayers in the 35 percent bracket, there is a breakpoint — the "20 percent breakpoint" — above which adjusted net capital gain is taxed at 20 percent and below which it is taxed at

15 percent; for taxpayers in the 32 percent, 24 percent, or 22 percent ordinary income tax brackets, the maximum rate on adjusted net capital gain is 15 percent."

Example 1 should state that the taxpayers are in the 35 percent tax bracket, below the 20 percent breakpoint.

Page 751: The Example should state that the taxpayer is in the 35 percent bracket, below the 20 percent breakpoint.

Delete the text of Footnote 8, and insert the following sentences in its place: "If the taxpayer's marginal tax rate is 37 percent, or is 35 percent and above the 20 percent breakpoint, but the amount of the taxable income in those brackets is less than the taxpayer's net capital gain, the adjusted net capital gain taxed at 20 percent will be the amount otherwise taxed at 37 percent plus the amount taxed at 35 percent that is above the 20 percent breakpoint. By way of example, assume the 37 percent rate applies to taxable income over $600,000 and the 35 percent breakpoint applies to taxable income over $500,000; further assume the taxpayer has taxable income of $525,000, of which $40,000 is adjusted net capital gain. In these circumstances, $25,000 of the adjusted net capital gain will be taxed at a 20 percent rate. ($525,000 minus $500,000 equals $25,000.) The remaining $15,000 of adjusted net capital gain will be taxed at 15 percent."

Page 754: Example 1 should state that the taxpayer is in the 35 percent bracket, below the 20 percent breakpoint.

Page 762: Change the heading of part 3 to include patents so as to read "3. Section 1221(a)(3): Patents, Copyrights, Literary, Musical, or Artistic Compositions, Etc."

Chapter 33

The Kiddie Tax

Page 835: The Problems state to assume the § 63(c)(5)(A) limitation on the basic standard deduction is $1,050. For 2022, the inflation-adjusted amount is actually $1,050. Rev. Proc. 2021-45, I.R.B. 2021-48. Nonetheless, continue to use the amount of $1,050 is answering the Problems.

Page 836 Statutory Update: The textbook notes on this page that the "initial approach taken by Congress in § 1(g) in 1986 was to tax the 'net unearned income' of a covered child at the top marginal rate of his or her parents ... [but] it took a different approach in the Tax Cuts and Jobs Act of 2017. For taxable years beginning after December 31, 2017, and before January 1, 2026, the child's net unearned income was to be taxed, not at the parental rate, but under the rates applicable to estates and trusts." The text goes on to note how highly compressed these rates are. However, within three years, in the Further Consolidated Appropriations Act, 2020, Congress returned to the initial approach — that is, to taxing the child at the top parental marginal rate — by repealing § 1(j)(4) (the provision making the estates and trusts rates applicable). Congress also made the repeal retroactive, at the taxpayer's election. Because of the repeal, the first full paragraph on page 838 may be deleted. Note the answers to the problem set, which do not require computation of tax liability, are not changed by the repeal of § 1(j)(4).

Page 838: As noted in the Statutory Update above, delete the first full paragraph.

Chapter 36

Transfers Between Spouses and Incident to Divorce

Page 888: In Problem (e), add to the first sentence that Maureen's continued use of the family home as her principal residence was pursuant to the terms of the property settlement agreement and the divorce decree.

Chapter 37

Like-Kind Exchanges of Real Property

Page 909: At the end of the carryover paragraph, add the following:

> Prompted by the 2017 limitation of § 1031 to exchanges of real property only, final regulations (T.D. 9935) have been issued, defining in great detail the term "real property" (for purposes of § 1031) for the first time in either the Code or the regulations. Under the regulations, real property "means land and improvements to land, unsevered natural products of land, and water and airspace superjacent to land." Reg. § 1.1031(a)-3(a)(1). Improvements to land are "inherently permanent structures and components of inherently permanent structures." Reg. § 1031(a)-3(a)(2)(i). An intangible interest in real property is itself real property, including "fee ownership; co-ownership; a leasehold; an option to acquire real property; [and] an easement …. Similar interests are real property … if the intangible asset derives its value from real property or an interest in real property and is inseparable from that real property or interest in real property." (Certain intangible assets, however, including stock, debt instruments, and partnership interests generally are not real property for purposes of § 1031.) Reg. § 1.1031(a)-3(a)(5). Except as otherwise provided, property that is real property under the law of a state or local jurisdiction in which it is located is real property for § 1031 purposes. Reg. § 1.1031(a)-3(a)(6).

Page 922: At the end of the first full paragraph, add the following:

> Pursuant to final regulations issued in 2020, the receipt in a deferred exchange of personal property that is "incidental" (as defined in the regulations) to the replacement real property has been added to the list of items that may be disregarded in determining whether the qualified intermediary safe harbor and certain other safe harbors have been satisfied. To be incidental, the personal property must be personal property "typically" transferred with the real property, the aggregate fair market value of which does not exceed 15 percent of the aggregate fair market value of the real property. Reg. § 1.1031(k)-1(g)(7)(iii). Because incidental personal property is non-like-kind property, it generally results in gain recognition under § 1031(b).

Chapter 41

Original Issue Discount

Page 1045: Add to Footnote 19 that for 2022 the inflation-adjusted limit on qualifying sales of property eligible for the cash method election of § 1274A(c) is $4,492,500. Rev. Proc. 2021-45, I.R.B. 2021-48.

Page 1046: Add to Footnote 20 that for 2022 the inflation-adjusted limit for qualified debt instruments eligible for the interest rate limitation of § 1274A(b) is $6,289,500. Rev. Proc. 2021-45.

Chapter 42

Limitations on Tax Shelters — Sections 465, 469, and 461(l)

Part A: Section 465 — The At Risk Rules

Page 1055: Delete Footnote 5. (*Alexander v. Commissioner*, referenced in the footnote, applied § 465(c)(3)(D), which limits the scope of § 465(b)(3)(A), because regulations had not then been issued under § 465(c)(3)(D). Regulations have since been issued, extending the application of § 465(b)(3)(A) to include activities described in § 465(c)(1) or (c)(3)(A). See Reg.§ 1.465-8(a).)

Part C: Section 461(l) — Excess Business Loss Disallowance

Statutory Update: The CARES Act amended the § 461(l) excess business loss limitation for taxpayers other than corporations to provide that it does not apply for taxable years beginning in 2018, 2019, or 2020. As originally enacted in 2017, the excess business loss limitation applied for taxable years beginning after December 31, 2017, and before January 1, 2026.

Statutory Update: The American Rescue Plan Act of 2021 extended the applicability of § 461(l)(1) by one year, from tax years beginning before January 1, 2026 to tax years beginning before January 1, 2027.

Page 1071 Problem: In answering parts (a) through (e) of the Problem, assume Years 1, 2 and 3 are 2021, 2022, and 2023, respectively, years to which the § 461(l) disallowance rule continues to apply following the 2020 CARES Act. (As the Problem already states, ignore the inflation adjustments under what is now § 461(l)(3)(C) as amended by the CARES Act.)

Page 1071 Assignment to Internal Revenue Code: § 461(l)(1)–(3), (6), as amended by the 2020 CARES Act and the American Rescue Plan Act of 2021. Review § 172(a), (b)(1)(A), (2), (c), (d)(1) as amended by the 2020 CARES Act.

Page 1072: Amend the first sentence of the second paragraph of the Overview to read as follows: As originally enacted in 2017, § 461(l) prohibited the deduction of "excess business losses" for taxpayers other than corporations for taxable years beginning after December 31, 2017, and before January 1, 2026; the 2020 CARES

Act postponed the application of § 461(l) to years beginning after December 31, 2020, rendering the provision inapplicable to tax years beginning in 2018, 2019, or 2020. The American Rescue Plan Act of 2021 extended the applicability of § 461(l)(1) by one year to tax years beginning before January 1, 2027.

At the end of the second paragraph of the Overview, add that the § 461(l)(3)(A) inflation-adjusted dollar amounts of $250,000 and $500,000 are increased for 2022 to $270,000 and $540,000, respectively. Rev. Proc. 2021-45, I.R.B. 2021-48. The statutory provision for the inflation adjustment is now § 461(l)(3)(C). Note that capital losses are not taken into account in the § 461(l) calculation and that the capital gains taken into account are subject to limitation. § 461(l)(3)(B), as amended. Also note that the calculation is made without regard to any deduction allowable under § 172 or § 199A, and also without regard to deductions, gross income, or gains attributable to the business of performing services as an employee. § 461(l)(3)(A) as amended.

Pages 1072-73: Assume the references to Years 1 and 2 in Example 1 and Example 2 and in the Analyses, are references to the years 2021 and 2022, years to which § 461(l), as amended, is applicable.

Page 1073 Footnote 28: As discussed in Chapter 28 of this Supplement, the net operating loss provisions of § 172 were amended by the CARES Act to (among other changes) postpone the "80-percent-of-taxable-income" limitation to 2021. Since the years under discussion in the Footnote 28 — namely, Years 1 and 2 — are assumed to be, per the previous paragraph of this Supplement immediately above, the years 2021 and 2022, the calculation in Footnote 28 remains accurate.