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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

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

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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.
>
> **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 are not 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

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> 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."

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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."

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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.

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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]

---

[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

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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.

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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."

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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.

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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.

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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

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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).

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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

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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.

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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

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(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.

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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

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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 761: In *Musselwhite v. Commissioner*, T.C. Memo. 2022-57, the Tax Court held that four land lots, sold by the taxpayer at a loss of over $1,000,000, were not stock in trade, inventory, or property held primarily for sale to customers in the ordinary course of business under § 1221(a)(1), but were instead capital assets, and the loss was thus a capital loss. In reaching this conclusion, the court relied upon an 8-factor test of the Court of Appeals for the Fourth Circuit: (1) the purpose for which the property was acquired; (2) the purpose for which the property was held; (3) improvements made by the taxpayer; (4) the frequency, number, and continuity of sales; (5) the extent and substantiality of the transaction; (6) the nature and extent of the taxpayer's business; (7) the extent of advertising, and (8) the listing of

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the property for sale directly or through a broker. Applying these factors led the court to conclude that their "overwhelming weight" was against the taxpayer.

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."

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Chapter 33

The Kiddie Tax

Page 835: The Problems direct students to assume the § 63(c)(5)(A) limitation on the basic standard deduction is $1,050. For 2022, the inflation-adjusted amount is actually $1,150. 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.

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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.

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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).

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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.

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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

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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.