Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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 § 280F(a)(1)(A), and thus there will be no disallowed deduction for purposes of § 280F(a)(1)(B).

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

Chapter 22

Casualty Losses

Note 1: On March 2, 2020, the Internal Revenue Service issued statistics compiled with respect to 2018 individual income tax returns filed through mid-November 2019. Those statistics reflect that approximately 18,280 2018 returns claimed a deduction for casualty and theft. By contrast, approximately 96,400 2017 returns claimed that deduction. The reduction in the number of returns claiming the deduction is attributable in large part 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.

Note 2: The Consolidated Appropriations Act, 2021 provides special time-limited rules for "qualified disaster-related personal casualty losses." Because of the limited time period during 2021in which these rules have applicability, assume they are not applicable in any of the problems presented in this Chapter.

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 §

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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 2021 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.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

Chapter 24

Charitable Deductions

Pages 563–564: In Problems 2 and 3, assume the contributions were made in 2022 unless your instructor directs otherwise. Thus, the time limited rules of the CARES Act and the Consolidated Appropriations Act, 2021 discussed below will not be applicable.

Page 566 (Footnotes 1 and 2): Both of these footnotes emphasize that the charitable deduction is not available to taxpayers who claim the standard deduction, i.e., the charitable deduction is a below-the-line deduction available only to those who itemize. The CARES Act provides, however, that, *for taxable years beginning in 2020*, an above-the-line deduction not to exceed $300 is available to "eligible individuals" making "qualified charitable contributions." § 62(a)(22). An "eligible individual" is defined as "any individual who does not elect to itemize deductions." § 62(f)(1). To be a "qualified charitable contribution" the contribution must be *made in cash* and is subject to other limitations. § 62(f)(2). Under the CARES Act, this above-the-line deduction was not available to contributions made in a taxable year beginning after 2020. The Consolidated Appropriations Act, 2021, however, extended the above-the-line deduction to contributions made in 2021 and increased it from $300 to $600 for a married couple filing a joint return (the deduction for non-married filers or married filers who file separately is still limited to $300). §170(p) (as added by the Act). The Act also provides that, although the deduction may only be claimed by non-itemizers, it will not reduce adjusted gross income. § 63(b) and (c) as amended by the Act.

Footnote 2 raises a question regarding the impact of the increased standard deduction on charitable giving. Not surprisingly, statistics released by Treasury in March 2020 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

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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).

Page 571: Pursuant to the CARES Act, the percentage limitations of § 170(b) are, at the taxpayer's election, suspended with respect to "qualified contributions," i.e., contributions paid in cash during the calendar year 2020 to an organization described in § 170(b)(1)(A) (subject to certain limitations). § 2205(a)(1) and (3)(A) and (B) of the CARES Act. The Consolidated Appropriations Act, 2021 extends through 2021 this suspension with respect to "qualified contributions" by both individuals and corporations. With respect to individuals, "qualified contributions" are allowed as a deduction only to the extent they do not exceed the excess of the

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

individual's contribution base (§ 170(b)(1)(H)) over all other charitable deductions allowed under § 170(b)(1). § 2205(a)(2)(A)(i) of the CARES Act. "Qualified contributions" exceeding this limitation may be carried over. § 2205(a)(2)(A)(ii) of the CARES Act. With respect to corporations, "qualified contributions" cannot be deducted to the extent they exceed the excess of 25 percent of the corporation's taxable income over the amount of other charitable contributions allowed under § 170(b)(2). § 2205(a)(2)(B)(i) of the CARES Act. A corporation's "qualified contributions" exceeding this limitation may be carried over. § 2205(a)(2)(B)(ii) of the CARES Act.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

Chapter 25

Limitations on Deductions

Part B: Section 265 — Expenses Related to Tax-Exempt Income

Page 616: At the end of the first full paragraph, add the following:

In Notice 2020-32, and subsequently in Rev. Rul. 2020-27, the Service restated the position it took in Rev. Rul. 83-3, 1983-1 C.B. 72, that "where tax-exempt income is earmarked for a specific purpose, and deductions are incurred in carrying out that purpose, § 265(a) applies because such deductions are allocable to the tax-exempt income," and accordingly, those otherwise allowable deductions are disallowed. Notice 2020-32 and Rev. Rul. 2020-27 applied this position with respect to the Payroll Protection Program established by the 2020 CARES Act. Under this Program loans made to employers in 2020 by the federal Small Business Administration would be forgiven, and the forgiveness of the loan would be excluded from the employer's gross income to the extent, among other requirements, the loan proceeds were spent largely on such otherwise-deductible expenses as payroll, rent, utilities, mortgage interest, and similar items. Notice 2020-32 and Rev. Rul. 2020-27 held that such expenses are allocable to exempt income — the forgiven loan excluded from gross income — and thus disallowed. Congress, however, in the Consolidated Appropriations Act, 2021 has overridden the Service's disallowance of the deduction, by providing in section 276 of that Act that "no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied by reason of the exclusion from gross income" of the forgiven loan. Accordingly, in Rev. Rul. 2021-2, the Service declared Notice 2020-32 and Rev. Rul. 2020-27 to be obsolete.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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*

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

(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 2021.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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 $600,000

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

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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."

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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 2021, the inflation-adjusted amount is actually $1,100. Rev. Proc. 2020-45, I.R.B. 2020-46. 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.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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).

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

Chapter 41

Original Issue Discount

Page 1045: Add to Footnote 19 that for 2021 the inflation-adjusted limit on qualifying sales of property eligible for the cash method election of § 1274A(c) is $4,356,800. Rev. Proc. 2020-45, I.R.B. 2020-46.

Page 1046: Add to Footnote 20 that for 2021 the inflation-adjusted limit for qualified debt instruments eligible for the interest rate limitation of § 1274A(b) is $6,099,500. Rev. Proc. 2020-45.

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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

Copyright © 2021 Carolina Academic Press, LLC. All rights reserved.

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 2021 to $262,000 and $524,000, respectively. Rev. Proc. 2020-45, I.R.B. 2020-46. 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.