2020 Update

For Students and Teachers

Federal Income Tax: Doctrine, Structure, and Policy Fifth Edition

by

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The Fifth Edition was current when it went to press on July 24, 2019. This update includes important subsequent developments, the principal ones being Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE) and Coronavirus Aid, Relief, and Economic Security Act (CARES).

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PART ONE: THE FUNDAMENTAL STRUCTURE OF THE FEDERAL INCOME TAX

Chapter 2: The Fundamental Structure of the Federal Income Tax

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The 2020 inflation-adjusted basic standard deduction amounts are $24.8K for joint-return filers, $18.65K for head-of-household filers, and $12.4K for all other individuals. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

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In response to a global pandemic and stay-at-home orders across America, including for many IRS employees, Congress (in the CARES Act) postponed the due date for filing returns and paying taxes that would otherwise have been due on April 15 until July 15. This extension not only included 2019 income tax returns and payments due on April 15, but also included the first two estimated income tax payments for 2020 otherwise due on April 15 and June 15. No interest or penalties will be assessed on any tax payments that are paid in full by the postponed due date.

Chapter 4: Rates and Allowances for Basic Maintenance

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The phase-out thresholds for § 199A for 2020 as indexed for inflation are $326.6K for joint-filers and $163.3K for all other returns. Thus, taxpayers are fully phased-out at $426.6k for joint-filers and $213.3K for all other returns, which means that taxpayers with taxable incomes above those amounts are fully subject to the alternative limit in § 199A(b)(2)(B) that is tied to W-2 wages and a percentage of unadjusted basis of qualified property in the qualified trade or business. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

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The inflation-adjusted tax rate schedules for 2020 can be found in *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

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The 2020 inflation-adjusted basic standard deduction amounts are $24.8K for joint-return filers, $18.65K for head-of-household filers, and $12.4K for all other individuals. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093. The additional standard deduction amount for taxpayers age 65 or older and/or blind is $1.3K or, if the individual is also unmarried and not a surviving spouse, $1.65K. Id.; § 63(f).

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The 2020 standard deduction amounts for an individual claimed as a dependent did not change from the 2019 amounts. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

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In its response to the financial devastation of the COVID-19 crisis, Congress enacted the "2020 Recovery Rebates." The 2020 Recovery Rebates, § 6428, are new, one-time refundable tax credits. The 2020 Recovery Rebates are up to $1.2K for every individual who has a Social Security number that is valid for work, and who is not claimed as a dependent by another taxpayer or characterized as a nonresident alien for tax purposes. Joint-filing taxpayers qualify for $2.4K (if one of the spouses is a member of the armed services, only one of the spouses has to have a Social Security number valid for work). Individuals with "qualifying children" under § 24(c) (who have a Social Security number that is valid for work) qualify for an additional $500 per "qualifying child" under age 17.

Congress designed the 2020 Recovery Rebates to be paid as quickly as possible. Therefore, the provision provides for an advance payment of the credit based upon the most current tax return filed (e.g., 2019, or 2018 if 2019 had not yet been filed). If the individual did not have a filing requirement in 2018 or 2019, under certain circumstances they would receive the credit in advance without having to provide any additional information. For example, individuals who received Social Security retirement or disability benefits, Veterans Administration benefits, or Supplemental Security Income who had not filed a 2018 or 2019 return received their 2020 Recovery Rebates as an automatic deposit into the same account where they received their respective benefits. The credit phases out by $5 for every $100 over certain adjusted gross income thresholds ($150K joint-filers, $112.5K head-of-household filers, and $75K for all other taxpayers). Therefore, individuals without any "qualifying children" would not receive an advance payment if their 2019 (or 2018) adjusted gross income was $198K, $136.5K, and $99K, respectively. Qualifying individuals who did not have a filing obligation and did not receive benefits as described above could register on the IRS website as a non-filer to receive their advance payment. By early June 2020, the IRS had delivered about 159M advanced payments. When these individuals file their 2020 tax returns, they will reconcile any advanced payments of the credit with their actual 2020 Recovery Rebates based upon 2020 information (e.g., adjusted gross income, qualifying children, filing status, etc.). If the actual 2020 Recovery Rebate of a taxpayer is higher than the advance payment, the taxpayer will receive the incremental amount. The statute does not require that a taxpayer repay any excess of the advance payment over the actual 2020 Recovery Rebate.

Chapter 5: Deductions for Off-The-Bottom Personal Expenses

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The SECURE Act retroactively extended the medical expense deduction floor percentage of 7.5% (versus 10%) to include tax years before 2021 under § 213(f).

PART TWO: VIEWING THE INCOME TAX THROUGH A CONSUMPTION-TAX LENS

Chapter 6: Viewing the Income Tax Through a Consumption-Tax Lens

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The maximum amount that a taxpayer can expense under § 179 in 2020 is $1.04M, reduced by eligible property placed in service during the year in excess of $2.59M. Thus, at $3.63M of eligible property placed in service in 2020, taxpayers will not be eligible for any § 179 deduction. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

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To mitigate financial consequences from the global pandemic, Congress (under the CARES Act) increased the § 163(j) business interest expense limitation from 30% to 50% of a business's "adjusted taxable income" for 2019 and 2020. Moreover, given the economic challenges in 2020 taxpayers can elect to use 2019 adjusted taxable income in lieu of 2020 adjusted taxable income pursuant to § 163(j)(10).

Nevertheless, § 163(j) does not apply to any business (other than a tax shelter) whose average annual gross receipts for the three years ending with the preceding tax year does not exceed $26M (as indexed for inflation for 2020). See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

Chapter 7: The Capitalization Principle in Practice

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For taxable years beginning in 2020, an entity (other than a tax shelter) meets the gross receipts test to use cash-method accounting under § 448(c) if its average annual gross receipts for the three-year period ending with the preceding tax year does not exceed $26M. See *Rev. Proc. 2019-44,* 2019-47 I.R.B. 1093.

PART THREE: DIFFERENTIATING AMONG THE BUSINESS, INVESTMENT, AND PERSONAL SPHERES

Chapter 8: The Basic Framework Governing Business and Investment Deductions

Page 217-18

In *Rev. Proc. 2019-38*, 2019-42 I.R.B. 942, the IRS provided a detailed safe harbor for treatment of rental real estate enterprises as a trade or business for purposes of determining QBI and the 20% deduction under § 199A.

Chapter 9: Defining the Personal Realm: Of Human Capital

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The SECURE Act retroactively extended the above-the-line deduction for "qualified tuition and related expenses" under § 222 through December 31, 2020. Section 222 had expired for tax years after 2017. Under the CARES Act, Congress added employer payments on employees' "qualified education loans" to the exclusion from gross income under § 127 for "educational assistance" payments made after March 27, 2020 through December 31, 2020. § 127(c)(1)(B). However, Congress did not increase the overall cap of $5,250, which is not indexed for inflation. § 127(a)(2).

PART FOUR: GROSS INCOME FROM MARKET TRANSACTIONS

Chapter 12: Forms of Compensation Income

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For 2020, the CARES Act adds certain employer paid "qualified education loans" to the exclusion for employer-paid-for-education under § 127(c)(1)(B).

PART FIVE: WEALTH TRANSFERS

Chapter 14: Recoveries for Personal Injury and Other Windfall Receipts

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The IRS ruled in December 2019, *PLR 201950004,* that a wrongful birth settlement to pay for the challenges of caring for a disabled child and to compensate the child's mother for her emotional distress due to her child's physical illness was excluded from gross income under § 104(a)(2) and Reg. § 1.104-1(c)(1).

Chapter 15: Gratuitous Transfers

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Under the CARES Act, Congress added to the exclusion from gross income of employer-paid "educational assistance" under § 127 employer-paid "qualified education loans" for interest and principal payments made after enactment of the CARES Act (March 27, 2020) through December 31, 2020. § 127(c)(1)(B).

Chapter 16: Charitable Contributions

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Congress added § 62(a)(22) in the CARES Act, providing an above-the-line charitable deduction of up to $300 for cash donations to qualifying public charities for 2020.

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The CARES Act allows individual taxpayers to elect out of any deduction ceilings on cash contributions made to qualifying public charities in 2020. Any qualified contributions above 2020 modified AGI can be carried forward for up to five years. CARES Act, Pub. L. No. 116-136, § 2005(a)(2)(A), 34 Stat. 281 (2020) (not codified in § 170).

Inflation-adjusted data in *Giving USA 2020: The Annual Report on Philanthropy for the Year 2019* indicates that despite the increased standard deduction under 2017 TCJA, 2019 charitable giving was up from 2018 by 2.4%. However, 2018 charitable giving was less than 2017 by 1.7% perhaps as a result of increased giving in 2017 in anticipation of 2017 TCJA. Charitable giving in 2017 was 3% higher than 2016, which was 2.7% higher than 2015 (all percentages are adjusted for inflation). Notably, the 2019 percentage of individual donors was under 70%, continuing a steady decrease since at least 1980. See also Scott A. Hodge, Tax Foundation, *Latest Data Shows That the Tax Cut and Jobs Act Did Not Dampen Charitable Giving* (June 2020).

Chapter 17: Income-Shifting Strategies

Page 432

The SECURE Act repealed the temporary tax rate change in the Kiddie Tax under § 1(j)(4) for tax years after 2019. However, for 2018 and 2019 taxpayers may elect to use the higher of the child's rate or the rate at which such income would be taxed if the income were attributed to the parent(s) in lieu of the 2017 TCJA imposed trust rates under § 1(e).

PART SIX: BORROWING, LENDING, AND INTEREST

Chapter 18: Borrowing, Lending, and Interest

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To mitigate financial consequences from the global pandemic, Congress (in the CARES Act) increased the § 163(j) business interest expense limitation from 30% to 50% of a business's "adjusted taxable income" for 2019 and 2020. Moreover, taxpayers can elect to use 2019 adjusted taxable income in lieu of 2020 adjusted taxable income pursuant to § 163(j)(10). Given the economic downturn caused by COVID-19 in 2020, electing to use 2019 adjusted taxable income will likely provide a larger 2020 business interest deduction for many taxpayers.

Section 163(j) does not apply to any business (other than a tax shelter) whose average annual gross receipts for the three years ending with the preceding tax year does not exceed $26M (as indexed for inflation for 2020). See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

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The SECURE Act retroactively extended the deduction for "qualified mortgage insurance" premiums for "Acquisition Indebtedness" as "Qualified Residence Interest" under § 163(h)(3)(E) through December 31, 2020. Section 163(h)(3)(E) had expired for tax years after 2017.

Chapter 19: **Cancellation-of-Debt Income**

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In *Rev. Proc. 2020-11*, 2020-6 I.R.B. 406, the IRS extended safe-harbor relief from recognizing COD income where student loans are discharged either because schools closed or as a result of fraud. *Rev. Proc. 2018-39*, 2018-34 I.R.B. 319, provides similar relief for students whose higher education loans were discharged under a settlement resolving certain types of claims of unlawful business practices, including unfair, deceptive, and abusive acts and practices. Previously, the IRS provided exclusions from gross income for students who attended Corinthian College or American Career Institutes Inc., whose loans were discharged by the U.S. Department of Education. *Rev. Proc. 2015-57*, 2015-51 I.R.B. 863; *Rev. Proc. 2017-24*, 2017-7 I.R.B. 916.

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The SECURE Act retroactively extended the § 108(a)(1)(E) exclusion of COD income from the cancellation of "qualified principal residence indebtedness" through December 31, 2020. Section 108(a)(1)(E) had expired for tax years after 2017.

PART SEVEN: REALIZATION AND RECOGNITION

Chapter 23: Tax Accounting Methods

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Taxpayers (other than a tax shelter) whose average annual gross receipts for the three years ending with the preceding tax year does not exceed $26M (as indexed for inflation for 2020) may use the cash method of accounting and are excused from inventory accounting. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

PART EIGHT: CAPITAL RECOVERY

Chapter 26: Recoveries of Expense Items: The Effect of Annual Accounting on Basis and Basis Recovery

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The inflation-adjusted amounts for 2020 for the 15% capital-gains rate ranges are as follows: taxable income more than $80K, but not more than $496.6K, for joint-filers; more than $53.6K, but not more than $469.05K, for head-of-household filers; and more than $40K, but not more than $441.45K, for all other individual taxpayers. The capital-gains rate of taxpayers with taxable incomes below those ranges for 2020 is 0% and the capital-gains rate of taxpayers with taxable incomes above those ranges for 2020 is 20%. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.

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Under the CARES Act, Congress delayed the imposition of the 80% taxable income limitation on NOL deduction carryforwards until after 2020. In addition, any NOLs generated in 2018, 2019, or 2020 can be carried back five years and forward indefinitely. Congress also delayed the effective date of the "excess business loss" limitation for non-corporate taxpayers under § 461(l) until 2021 (and before 2026).

For 2020, the gross receipts threshold for using the completed-contract method is $26M. See *Rev. Proc. 2019-44,* 2019-47 I.R.B. 1093.

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In *Mihelick v. United States*, 927 F. 3d 1138 (11th Cir. 2019), the 11th Circuit Court of Appeals held that § 1341 applied in the case of a divorcee repaying ½ of her former spouse' excessive compensation determined through litigation initiated by her sister-in-law. After Ms. Mihelick paid her ex-spouse her 50% share of the $600K overpayment she filed a refund claim under §§ 165 and 1341. Although the IRS refunded her ex-husband's repayment of $300K, the District Court denied Ms. Mihelick's refund claim as a matter of law through a summary judgment motion. Ms. Mihelick, represented by counsel, appealed the District Court's decision and prevailed. Indeed, the 11th Circuit opinion authored by Judge Rosenbaum begins as follows: "Inscribed above the main entrance of the Internal Revenue Service office in Washington, D.C., is a quotation from Supreme Court Justice Oliver Wendell Holmes Jr.: 'Taxes are what we pay for a civilized society.' An admirable outlook, yet even Justice Holmes would likely agree that it is uncivilized to impose taxes on citizens for income they did not ultimately receive. But that is precisely the result the government asks us to uphold today." Id. at 1138.

For a detailed discussion regarding issues related to the characterization of § 1341 deductions as "not MIDs" under § 67(b)(9) and the disallowance of MIDs for 2018-2025 in the 2017 TCJA, see Douglas A. Kahn*, Return of an Employee's Claim of Right Income,* 163 TAX NOTES 1819 (2019).

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In response to a global pandemic and stay-at-home orders across America, which apply to many IRS employees, Congress (in the CARES Act) automatically postponed the due date for filing returns and paying taxes (that otherwise would have been due on April 15) until July 15. This extension not only included 2019 income tax returns and payments due on April 15, but also included the first two estimated income tax payments for 2020 otherwise due on April 15 and June 15. No interest or penalties will be assessed on any tax payments that are paid in full by the postponed due date.

Chapter 28: Depreciation

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The maximum amount of § 179 deduction allowable for a sport utility vehicle in 2020, as indexed for inflation, is $25.9K. See *Rev. Proc. 2019-44*, 2019-47 I.R.B. 1093.