

***Federal Income Tax:
Doctrine, Structure, and Policy
Fourth Edition***

2016 Cumulative Update

For Students and Teachers

by

***Joseph M. Dodge, J. Clifton Fleming, Jr.,
and Robert J. Peroni***

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

Please do not hesitate to contact us directly with comments or questions.

Joseph Dodge
jdodge@law.fsu.edu

Cliff Fleming
flemingc@law.byu.edu

Bob Peroni
rperoni@law.utexas.edu

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Carolina Academic Press, LLC
700 Kent Street
Durham, NC 27701
Telephone (919) 489-7486
Fax (919) 493-5668
www.caplax.com

Chapter 1

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

Page 5

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

Page 10

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

Page 18

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 The Medicare tax changes described in footnote 17 were not repealed, amended, or delayed by 2012 ATRA.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

Page 23

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

Page 28

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

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

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

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

Recent judicial developments have chipped away at the deference accorded to regulations by *Chevron*. The quotation from *Mead* on page 27 of the casebook is popularly referred to as “*Chevron* step zero.” It asks whether Congress has delegated authority to an agency to cure statutory ambiguity or fill statutory gaps and whether the regulation in question was promulgated pursuant to that authority. IRC § 7805(a) is usually regarded as providing the necessary congressional delegation of authority to promulgate income tax regulations and the act of expressly relying on that provision to promulgate a regulation is usually taken as conclusive evidence that the regulation was issued pursuant to delegated authority. Thus, income tax regulations are ordinarily considered to automatically satisfy *Chevron* step zero. This status quo was disturbed by the Supreme Court’s opinion in *King v. Burwell*, 135 S.C.t. 475 (2015.)

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

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

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

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

In *Altera Corp. v. Comm’r*, 145 TC No. 3 (2015), the Tax Court held that *Chevron* step two (whether the agency’s interpretation is “based on a reasonable construction of the statute”) implicitly incorporates a requirement that a regulation must be the product of the agency’s “reasoned decision-making,” which means that “the agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.” If this becomes the prevailing judicial view, Treasury will have to make a persuasive showing that the interpretation asserted in a particular regulation was arrived at through an informed and thoughtful process in addition to being a reasonable position.

Page 32

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

Chapter 2

Basic Income Tax Principles

Page 40

In Notice 2014-21, 2014-16 I.R.B. 938, the IRS held (1) that virtual currency such as Bitcoin is property rather than currency for federal tax purposes, (2) that a taxpayer who receives virtual currency in exchange for money or property must treat the then fair market value of the virtual currency as an income inclusion or an amount realized, (3) that such a taxpayer takes a basis in the virtual currency equal to its fair market value at the time of receipt, and (4) that a taxpayer who pays for goods or services with virtual currency must recognize gain or loss equal to the difference between the currency's then fair market value and the taxpayer's basis. The gain or loss will be capital gain or loss if the virtual currency qualifies as a capital asset in the taxpayer's hands under IRC § 1221.

Page 50

See entry for **Page 32**.

Page 52

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

Page 57

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

Page 59

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

Page 65

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

Page 67

We were prescient. 2012 ATRA permanently revived IRC § 68 for tax years beginning after December 31, 2012. **For 2016, the adjusted gross income thresholds at which IRC § 68 begins to bite are \$311,300 for marrieds filing jointly and for surviving spouses, \$285,350 for heads of households, \$259,400 for single filers, and \$155,650 for marrieds filing separately. See Rev. Proc. 2015-53 § 3.15, 2015-44 I.R.B. 615. These thresholds will be annually adjusted for inflation.** Section 68 is popularly known as the "Pease limitation" because it was originally advanced by the late Congressman Donald Pease of Ohio.

Page 68

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

Chapter 4

Rates and Allowances for Basic Maintenance

Pages 86 and 90

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

Page 92

In *U.S. v. Windsor*, 133 S. Ct. 2675 (2013), the Supreme Court declared Defense of Marriage Act § 3 unconstitutional. Sorting out the scope of the Court's opinion and its full impact on federal income tax law is a work in progress. However, Rev. Rul. 2013-17, 2013-2 C.B. 201, holds that same-gender couples who are considered married under the law of the state where their ceremony occurred can now file joint federal income tax returns even if they are presently residing in a state that does not recognize their marriage. If they choose not to file jointly, they must use the IRC § 1(d) rate table for marrieds filing separately, rather than the § 1(c) rate table for unmarried individuals. In contrast, Rev. Rul. 2013-17 holds that individuals are not considered married for federal income tax purposes if they “have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state, and the term ‘marriage’ does not include such formal relationships.” Finally, Rev. Rul. 2013-17 affirms the holding in Rev. Rul. 58-66 that a couple will be treated as husband and wife for federal income tax purposes if they have entered into a common law marriage in a state that recognized their relationship as a valid marriage even if they are now living in a state that does not recognize their common law marriage.

In *Obergefell v. Hodges*, 135 S.Ct. 2071(2015), the Supreme Court held that state laws reserving marriage to heterosexual couples are “invalid to the extent they exclude same-sex couples from civil marriage on the same terms and conditions as opposite-sex couples,” and also held that “there is no lawful basis for a State to refuse to recognize a lawful same-sex marriage performed in another State on the ground of its same-sex character.” These holdings do not seem to affect any of the IRS positions in Rev. Rul. 2013-17.

Page 95

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

Page 98

2012 ATRA granted additional marriage penalty relief by permanently providing that the standard deduction for joint filers and surviving spouses is twice the size of the inflation-adjusted standard deduction for singles and marrieds filing separately.

2012 ATRA restored the personal exemption phase-out (popularly known as the PEP and referred to on page 103). This phase-out reduces each individual taxpayer's total amount of personal exemption deductions by 2% for each \$2,500, or fraction thereof, of the taxpayer's adjusted gross income in excess of the taxpayer's "applicable amount." However, if the taxpayer is married filing separately, the preceding \$2,500 amount is reduced to \$1,250. The applicable amounts, to be inflation adjusted after 2013, are:

\$300,000 for joint filers and surviving spouses

\$275,000 for heads of households

\$250,000 for singles

\$150,000 for marrieds filing separately.

Page 105

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

Chapter 5

Deductions for Off-the-Bottom Personal Expenses

Page 112

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

Page 116

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

Chapter 6

Viewing the Income Tax Through a Consumption Tax Lens

Page 157

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

Page 158

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

Chapter 7

The Capitalization Principle in Practice

Page 170

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

Page 174

As explained above, Reg. § 1.162-6 is repealed effective January 1, 2014. Its replacement is too complex to warrant coverage in the basic tax course. Therefore, Problem 2.(b) can be omitted.

Page 177

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

Pages 184-87

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

Effective January 1, 2014, the material on pages 184-187 up to the Problems was superseded by new Reg. § 1.263(a)-3. This new Regulation provides that an expenditure qualifies as a deductible repair expense if it is incurred with respect to a unit of business or investment property and if

- (1) The expenditure is *not* for a betterment to the unit of property,
- (2) The expenditure does *not* restore the unit of property, and
- (3) The expenditure does *not* adapt the unit of property to a new or different use.

An expenditure that effects either a betterment, restoration, or adaptation is, generally speaking, not a deductible repair expenditure unless it is covered by the *de minimis* exception that is limited to \$5,000 in some cases and \$2,500 in others (Reg. § 1.263(a)-1(f); Notice 2015-82, 2015-50 I.R.B. 133) or is covered by the small taxpayer exception (Reg. § 1.263(a)-3(h)), or the routine maintenance exception (Reg. § 1.263(a)-3(i)).

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

Problem 1, *see* Reg. § 1.263(a)-3(d) (“generally must capitalize”)

Problem 2(a), *see* Reg. § 1.263(a)-3(j)(3), Example 13; Reg. § 1.263(a)-3(k)(7), Examples 14 and 15; Reg. § 1.263(a)-3(l)(1), (2).

Problems 2(b), (c), *see* Reg. § 1.263(a)-3(j)(3), Examples 1 and 2, and Regulations cited with respect to Problem 2(a).

Problem 2(d), *see* Reg. § 1.263(a)-2(d)(1); Reg. § 1.263(a)-3(j)(1)(ii); Reg. § 1.263(a)-3(j)(3), Example 7.

Problem 2(e), *see* Reg. § 1.263(a)-3(j)(3) Examples 6, 8; Reg. § 1.263(a)-3(k)(7), Examples 24, 28, 29.

Problem 2(f), *see* Reg. § 1.263(a)-3(k)(1); Reg. § 1.263(a)-3(k)(7), Example 3.

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

Chapter 8

The Basic Framework Governing Business and Investment Deductions

Page 207

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

Chapter 9

Defining the Personal Realm: Of Human Capital

Pages 222-23

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

The PATH Act extended the IRC § 222 deduction for “qualified tuition and related expenses” to cover expenses paid before January 1, 2017. The HOPE credit’s \$2,500 limit, partial refundability, and four-year coverage were extended by 2012 ATRA to apply to tax years beginning before 2018.

Chapter 10

Dual Purpose Outlays

Page 239

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

Chapter 11

Allocating Costs Between the Income Production and Personal Realms

Page 271

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

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

Chapter 12

Forms of Compensation Income

Page 278

See entry for **Page 32**.

Page 288

In *Shankar v. Comm’r*, 143 TC 140 (2014), Citibank had credited the taxpayer with 50,000 “Thank you Points” for opening a Citibank account. The taxpayer requested that these points be used to acquire an airline ticket. Citibank purchased the ticket, delivered it to the taxpayer, and issued a Form 1099 showing that the taxpayer had received income equal to the ticket’s \$668 purchase price. The Tax Court held that this amount was includable in the taxpayer’s gross income.

Chapter 14

Recoveries for Personal Injury Other Windfall Receipts

Page 320

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

Pages 321-23

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

In *Perez v. Comm’r*, 144 T.C. No. 4 (2015), the taxpayer “donated” her eggs to infertile couples and received \$20,000 for doing so. The “donation” contracts stated that this was consideration for pain and suffering incident to the donation procedure and not for sale of the eggs. Taxpayer contended that the consideration was excludable under IRC § 104(a)(2). The Tax Court held that the consideration was not damages for a personal injury within the meaning of IRC § 104(a)(2) but was, instead, includable in gross income as compensation for services.

Chapter 15

Gratuitous Transfers

Page 332

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

Page 333

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

Pages 335-36

The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 adds new IRC § 1014(f)(1) to the Code. Generally speaking, this new provision requires that the federal estate tax value of inherited property must be used as the property's basis for income tax purposes. This Act also adds to the Code a new IRC § 6035 that directs executors of estates required to file a federal estate tax return to furnish each recipient of a property bequest and the IRS with an information return. The information return must show the estate tax value of the property bequest.

Page 351

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

Chapter 17

Income Shifting Strategies

Page 387

In Notice 2014-68, 2014-47 I.R.B. 842, the IRS addressed employer-established programs under which employees elect to give up vacation, sick, or personal leave in exchange for the employer contributing cash to IRC § 170 (c) organizations for the benefit of victims of the West African Ebola epidemic. The Notice states that the IRS will not treat such cash payments as gross income or wages of the participating employees if the payments are made before January 1, 2016. Nor will the IRS treat the opportunity to participate in this type of program as causing employees to be in constructive receipt of income. The employees may not claim a charitable contribution deduction with respect to these payments but the respective employers may deduct the payments under IRC § 162 if the requirements of that provision are satisfied.

Chapter 18

Borrowing, Lending, and Interest

Page 426

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

Chapter 19

Cancellation-of-Debt Income

Page 436

In the fourth line, substitute "side" for "sits."

Chapter 20

Debt and Property

Page 456

The PATH Act extended IRC §§ 108(a)(1)(E), (h) through the end of 2016 but there was no further extension at the time this update was written.

Page 462

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

Chapter 23

Tax Accounting Methods

Page 543

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

Page 572

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

Chapter 24

Realization of Loss on the Destruction or Theft of Property

Pages 583-84

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

Chapter 25

Capital Gains and Losses

Page 601

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

Page 612

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

Pages 616 and 623

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

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

Chapter 26

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

Page 635

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

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

Chapter 28

Depreciation

Pages 702-03

See the entries for Page 157 and Page 158.