August 2016 Student Update Memorandum for

Miller & Maine's

The Fundamentals of Federal Taxation: Problems and Materials

(3rd ed. 2013)

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CAROLINA ACADEMIC PRESS
Durham, North Carolina

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Chapter 2:
Gross Income

Page 20: At the end of the first paragraph of Section 3 (Long-Standing Administrative Practices), add the following:

The IRS has recently clarified when Indian tribal government benefits are excludable under the general welfare exclusion. *See* Rev. Proc. 2014-35, 2014-6 IRB 1.

Page 31: In the Related Matters, add a new bullet point at the end:

Recovery for Wrongful Incarceration. The 2015 PATH Act added new section 139F, which provides an exclusion from gross income for certain payments for wrongful incarceration.

Chapter 3:
Gains and Losses from Dealings in Property

Page 47: In the Related Matters, add new bullet points at the end:

Virtual Currency. Virtual currency is a recently invented digital medium of exchange. "Bitcoin is one example of a convertible virtual currency. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies." Notice 2014-21, 2014-16 I.R.B. 938. One issue concerning this currency is whether it is property for purposes of gain and loss recognition under the Code. The IRS has answered that question in the affirmative. *See id.*, Q&A 6. This means, for example, that a person who buys a bitcoin when it was worth $100 and spends it when it is worth $150 would have $50 of gross income when he or she spends the Bitcoin.

Human Egg Donors. The Tax Court recently concluded that a $20,000 payment received for service as a human egg donor did not constitute an amount realized for sale of property. Nor was it excludable from income as a recovery for personal injuries under section 104(a)(2). Instead the payment was taxable as compensation income. Perez v. Commissioner, 144 T.C. 51 (2015).

Chapter 5:
Discharge of Indebtedness

Page 74: In the third bullet, please note the following:

The 2015 PATH Act extended through 2016 the section 108 exclusion from gross income of discharge of qualified principal residence indebtedness. IRC § 108(a)(1)(E).

Chapter 8:
Capital Expenditures

Pages 116-120: Replace the main text with the following new material:

c. Treasury Regulations

Although regulations under section 263 existed for some time, they were long considered vague, subjective, and the source of much litigation. As a result, the Treasury in recent years has replaced these regulations with sets of new regulations expanding and clarifying the rules surrounding capital expenditures. In 2004, the Treasury issued final regulations on the capitalization of costs related to *intangible* property. Treas. Reg. § 1.263(a)-4. More recently, in September 2013, the Treasury issued final regulations on the capitalization of costs related to *tangible* property. Treas. Reg. § 1.263(a)-1 (providing general rules for capital expenditures), -2 (providing rules for amounts paid for the acquisition or production of tangible property), 3(providing rules for amounts paid for the improvement of tangible property). *See also* Treas. Reg. § 1.162-3 (providing rules for materials and supplies), -4 (addressing repairs and maintenance). The following material addresses selected categories of capital expenditures for both tangible and intangible property. All references to regulations are to final regulations currently in effect.

3. Capitalization Rules Governing Tangible Property

a. Amounts Paid to Acquire Tangible Property

Regulations under section 263, effective September 19, 2013, require capitalization of amounts paid to acquire "a unit of real or personal property" (other than "materials or supplies"). Treas. Reg. § 1.263(a)-2(d)(1). *But see* Treas. Reg. 1.263(a)-1(f) (allowing certain taxpayers to currently deduct de minimis costs).

The regulations provide guidance for determining the appropriate *unit of property*. *See generally* Treas. Reg. § 1.263(a)-3(e). The definition of a unit of property has multiple sub definitions in various contexts. For example, in the real property context a building is usually a unit of property but in the condominium context a single apartment within a larger building may be a unit of property if the taxpayer only owns one apartment. Treas. Reg. § 1.263(a)-3(e)(2). For personal property the general rule is that "all the components that are functionally interdependent comprise a single unit of property." Treas. Reg. § 1.263(a)-3(e)(3)(i). Two components are functionally interdependent if placing one component in service is dependent on placing the other component in service. *Id.* Thus, for example, though a train locomotive may have many component parts it is regarded as a single unit of property because all parts are needed to make it work. Treas. Reg. § 1.263(a)-3(e)(6), ex 8.

The regulations also provide guidance on the treatment of *materials and supplies*, which are deductible under section 162. *See* Treas. Reg. § 1.162-3. Materials and supplies are defined as tangible property used or consumed in the taxpayer's operations that has an economic useful life

of 12 months or less or cost $200 or less. Treas. Reg. § 1.162-3(a)(2), (c)(1)(iii), (iv). Amounts paid for materials and supplies are deductible in the year in which the supplies are used or consumed in the taxpayer's operations. Treas. Reg. § 1.162-3(a)(1). If no record of consumption is kept, the amounts are deductible in the year in which they are paid. Treas. Reg. § 1.162-3(a)(2).

It should be noted that capitalized acquisition costs include not only the purchase price of an asset, but also related transaction costs such as appraisal fees, commissions, and accounting and legal fees. *See* Treas. Reg. § 1.263(a)-2(f)(1) (requiring capitalization of amounts paid to facilitate the acquisition of real or personal property). For an early case illustrating this principle, see Woodward v. Commissioner, 397 U.S. 572 (1970). For example, assume a taxpayer purchases a building for $100,000 and in connection with the purchase incurs $5,000 in appraisal fees and closing costs. The taxpayer must capitalize all acquisition costs and so his basis in the building becomes $105,000. When the taxpayer will recover the capitalized acquisition costs depends on the applicable rules governing tax depreciation of buildings. The regulations provide a list of inherently facilitative costs that generally must be capitalized as transaction costs. Treas. Reg. § 1.263(a)-2(f)(2)(ii). But the regulations also provide an exception for certain costs incurred in investigating real property purchases (e.g., costs connected with deciding whether to purchase real property), which are currently deductible as expansion costs. Treas. Reg. § 1.263(a)-2(f)(4), ex. 8.

b. Amounts Paid to Construct Tangible Property

As with acquisition costs, the costs of producing a unit of real or personal property must be capitalized. Treas. Reg. § 1.263(a)-2(d)(1). To provide parity with a purchaser of property, all costs allocable to the construction must be capitalized and included in the constructed asset's basis. This includes costs that otherwise would be immediately deductible expenses, for example, wages paid to construction workers, rent paid for construction tools, interest paid on construction loans, etc. Although section 263(a)(1) is the authority for this rule, the provision does not clearly specify all the construction costs that should be capitalized.

In Commissioner v. Idaho Power, 418 U.S. 1 (1974), the Supreme Court held that equipment depreciation allocable to the taxpayer's construction of capital facilities must be capitalized under section 263(a)(1). The facts were as follows: The taxpayer, a public utility company, used its own transportation equipment (e.g., trucks) to construct capital facilities having a useful life of more than one year. The taxpayer claimed depreciation deductions on the equipment used in constructing its capital facilities; the deductions were computed based on the 10-year life of the equipment. According to the Court, requiring the capitalization of construction-related equipment depreciation by the taxpayer which does its own construction work maintains tax parity with the tax- payer which has such work done independently. Therefore, the public utility company had to add the equipment depreciation to the adjusted basis of the capital facility and depreciate over the 30-year useful life of that property. The principles of *Idaho Power* have been codified in section 263A, discussed more fully below.

It should be noted that, like facilitative transaction costs in purchases, amounts paid to facilitate the production of real or personal property must be capitalized. Treas. Reg. § 1.263(a)2(f).

c. Amounts Paid to Sell Tangible Property

The costs of selling or otherwise disposing of tangible property, such as sales commissions and fix-up costs, are not deductible when paid or incurred; rather they must be capitalized. Treas. Reg. § 1.263(a)-1(e)(1). Disposition costs are subtracted from the amount realized upon disposition. *Id*.

In contrast, removal costs (i.e., costs of retiring, removing, or discarding property) are generally deductible in the year the asset is retired and the costs are incurred. *See* Rev. Rul. 2000-7, 2000-1 C.B. 712 (ruling that costs of removing telephone poles were deductible even though new poles were installed); Rev. Rul. 94-12, 1994-1 C.B. 36 (ruling costs of removing and disposing of underground storage tanks were deductible). *But see* IRC § 280B (requiring capitalization of demolition costs). The final regulations generally do not affect the holding of these previous rulings. *See* Treas. Reg. § 1.263(a)-3(g)(2) (clarifying the treatment of removal costs in certain contexts).

d. Amounts Paid to Defend or Perfect Title to Tangible Property

The costs incurred in defending or perfecting title to real or personal property are considered to be a part of the cost of the property and they must be capitalized. Treas. Reg. § 1.263(a)-2(e). This rule is functionally equivalent to the general rule requiring acquisition costs to be capitalized. As one would expect, the tax treatment of litigation costs varies depending on the nature of the litigation. To be immediately deductible, litigation must not relate to the title of property, but rather to income from it. To determine the "origin of the claim," a fact specific inquiry articulated by the Supreme Court in United States v. Gilmore, 372 U.S. 39 (1963), consideration must be given to the issues involved, the nature and objectives of the suit in which the expenditures were made, the defenses asserted, the purpose for which the claimed deductions were expended, the background of the litigation, and all facts pertaining to the entire controversy. To illustrate, "[a]ttorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents." Treas. Reg. § 1.212-1(k). The deductibility of attorney's fees is explored more fully in Chapter 35.

e. Amounts Paid to Improve Tangible Property

It has long been the rule that expenditures for replacements or improvements (e.g., the cost of replacing an entire roof) must be capitalized, while expenditures for repairs and maintenance (e.g., the cost of replacing a few shingles on a roof) may be deducted currently. But distinguishing between nondeductible improvements and deductible repairs often is difficult. Read *Midland Empire Packing Co. v. Commissioner* and *Mt. Morris Drive-In Theatre Co. v. Commissioner*, included in the materials below, for an illustration of how courts historically addressed the repair versus improvement distinction. Can you reconcile the two decisions?

Final regulations that became effective on September 19, 2013 attempt to provide better guidance for distinguishing deductible repairs from capital improvements. In fact, the temporary regulations are often referred to as the IRS's "repair" regulations. Generally, amounts paid for repairs and maintenance to tangible property are deductible unless they are required to be capitalized. Treas. Reg. § 1.162-4(a). A taxpayer must generally capitalize expenditures that result in an "improvement" to a "unit of property."

In order to determine whether an amount improves an asset, the relevant unit of property must first be determined. For example, maintenance on an aircraft engine might be deemed a deductible repair if the unit of property was the entire plane but a nondeductible improvement if the unit of property was just the engine. As noted above, the final regulations provide rules for determining the appropriate unit of property. For personal property the general rule is that all the components that are functionally interdependent comprise a single unit of property. Treas. Reg. § 1.263(a)-3(e)(3)(i). Special rules are provided for real property.

Once the appropriate unit of property is ascertained, the question then turns to whether that unit of property was improved. The final regulations provide that a unit of property is deemed to be improved in three situations—(1) betterments, (2) restorations, and (3) adaptations to new or different uses. Treas. Reg. § 1.263(a)- 3(d). (Note that under a regulatory safe harbor, certain routine maintenance procedures performed on a unit of property, including certain buildings, are deemed not to improve property. Treas. Reg. § 1.263(a)-3(i).)

First, expenditures for *betterments* to a unit of property must be capitalized. "Betterments" are changes to the property that (1) ameliorate a material condition or defect in the property, or (2) are a material addition to the property, or (3) are reasonably expected to materially increase the productivity, efficiency, strength, quality, or output of the unit of property. Treas. Reg. § 1.263(a)-3(j)(1)(i)-(iii). Whether a change is a betterment is determined under a facts and circumstances test that is illustrated in the regulations by numerous examples. Treas. Reg. § 1.263(a)-3(j)(3).

Second, expenditures for *restorations*, like expenditures for betterments, must be capitalized. A restoration occurs in a variety of situations but typically involves a major renovation or refurbishing of an asset. *See* Treas. Reg. § 1.263(a)-3(k)(1). Thus, for example, expenditures to restore the functionality of a farm outbuilding that has reached a state of disrepair so great that it is no longer usable would be restoration expenditures and must be capitalized. *See* Treas. Reg. § 1.263(a)-3(k)(7), ex. 6.

Third, expenditures that *adapt a unit of property to a new or different use* (if the adaptation is not consistent with the taxpayer's ordinary use at the time originally placed in service by the taxpayer) must also be capitalized. Treas. Reg. § 1.263(a)-3(l)(1). For example, the conversion of a manufacturing building into a showroom for the manufacturer's products would constitute such an adaptation. *See* Treas. Reg. § 1.263(a)-3(l)(3), ex. 1.

Reconsider *Midland Empire Packing Co. v. Commissioner* and *Mt. Morris Drive-In Theatre Co. v. Commissioner*, included in the materials below. Would these cases be decided the same way under the new final regulations? Hint: *See* Treas. Reg. § 1.263(a)-3(j)(3), ex. 12.

Note that in the past, the IRS applied the so-called "plan of rehabilitation" doctrine as set forth in United States v. Wehrli, 400 F.2d 686 (10th Cir. 1968): "[A]n expenditure made for an item which is part of a 'general plan' of rehabilitation, modernization, and improvement of the property, must be capitalized, even though, standing alone, the item may appropriately be classified as one of repair." The final regulations abandon this doctrine.

Under the regulations an improvement to a unit of property generally becomes part of that unit of property rather than a separate unit of property. Treas. Reg. § 1.263-3(e)(4). Thus, a new roof is simply part of the building rather than a separate unit. The significance of this fact is limited, however, by the separate requirement that the new roof must be depreciated over the life of a new building rather than over the remaining useful life of the improved building. *See* IRC § 168(i)(6). Tax depreciation is the subject of the next chapter.

Chapter 9:
Depreciation and Amortization

Page 135: In "1. Section 179," note the following:

In 2014, the maximum section 179 deduction dropped back to $25,000 (with a spending phase-out starting at $200,000). In late December 2014, however, Congress passed The Tax Increase Prevention Act of 2014, which raised the deduction back to $500,000 for all of 2014 (with a spending phase-out starting at $2,000,000). For tax years beginning after 2014, the section 179 maximum deduction was slated to fall again to $25,000 (with a spending phase-out starting at $200,000). However, in the 2015 PATH Act Congress retroactively extended and made permanent the $500,000 maximum amount that can be expensed under section 179 and also made permanent the $2,000,000 phase out amount. *See* IRC § 179(b). In addition, Congress indexed those amounts for inflation for years after 2015. IRC § 179(b)(6).

Page 136: In "2. Section 168(k)," note the following:

The Tax Increase Prevention Act of 2014, signed into law in late December 2014, extended 50% bonus depreciation for the entirety of 2014. The extra depreciation deduction was scheduled to expire for purchases beginning in 2015 (2016 in the case of property with a longer production period and certain noncommercial aircraft). However, the 2015 PATH Act further extended the life of the provision through 2019. IRC § 168(k)(1)-(2).

Chapter 10:
Deductible Personal Expenses: Casualty and Theft Losses

Page 162: In Related Matters, under Bad Debts, insert the following sub-bullet at the end:

See Cooper v. Commission, T.C. Memo 2015-191 (holding that a taxpayer who made loans could not claim an ordinary loss because he was not in the lending business and he could not claim a short-term capital loss because bankruptcy of the borrower did not necessarily imply total worthlessness of loan).

Chapter 11:
Other Personal Expenses

Page 166: In "A. Qualified Residence Interest," replace the last three sentences of the first paragraph at the top of the page with the following:

An interesting question is whether the section 163(h)(3) limitations on the deductibility of mortgage interest ($1million of acquisition indebtedness plus $100,000 of home equity indebtedness) are applied on a *per-residence* basis (for a total of $1.1 million of debt) or on a *per-taxpayer* basis (for a total of $2.2 million of debt). The Ninth Circuit recently reversed the Tax Court and held, contrary to the Service's position, that the limitations are applied on a per taxpayer basis. Voss v. Commissioner, 796 F.3d 1051 (9th Cir., 2015). Do you think the decision, which allows unmarried taxpayers who buy an expensive residence together to deduct twice the amount of interest spouses would be allowed to deduct, comports with the language of the statute?

Page 166: In "B. State and Local Taxes," note the following:

The Tax Increase Prevention Act of 2014 extended through 2014 the section 164 deduction for state and local general sales taxes. The 2015 PATH Act made it permanent. IRC § 164(b)(5).

Chapter 12:
The Deduction Hierarchy

Page 177: In "A. Itemized Deductions Versus the Standard Deduction," note the following:

For 2016, the standard deduction is $12,600 for joint filers and $6,300 for unmarried individuals. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

Pages 178-179: Note the following with respect to the personal exemption:

In 2016, the personal exemption amount is $4,050. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

Chapter 14:
Ordinary Tax Rates and Taxpayer Classification

Page 213-14: Substitute a new section 1 (Marital Status):

1. Marital Status

Normally marital status for tax purposes is determined at year's end. *See* IRC § 7703(a)(1). *See also* IRC § 6013. Marriage is a legal union recognized by state law. Under federal tax law, however, a person who is legally separated from her spouse under a decree of divorce or separate maintenance is not considered married for federal tax purposes. IRC § 2(b)(2)(A). Nor is a person considered married for tax purposes if the person's spouse is a nonresident alien. IRC § 2(b)(2)(B). In addition, sometimes if a married couple lives apart for an extended period, they are treated as unmarried for tax purposes. IRC § 7703(b). On the other hand, a person whose spouse died during the tax year is treated as married for tax purposes for that tax year. IRC § 2(b)(2)(C). Thus, if one's spouse dies during the tax year, it is permissible for such person to file a joint return with the decedent spouse in the year of death. IRC § 7703(a)(1).

Same Sex couples and Domestic Partners*:* Until recently, same sex couples who were legally married under state law could not file joint federal income tax returns. *See* IRC § 6013(a) (reserving that right to wives and husbands); *see also* Defense of Marriage Act (DOMA), 1 U.S.C. § 67; 28 U.S.C. § 1738C, section 3 ("In determining the meaning of any act of Congress, or of any ruling, regulation or interpretation of the various administrative bureaus and agencies of the United States, the word "marriage" means only a legal union between one man and one woman, and the word "spouse" refers only to a person of the opposite sex who is a husband or a wife.").

However, in June of 2013 in the case of *United States v. Windsor* the U.S. Supreme Court declared DOMA's denial of the estate tax marital deduction to a lawfully married same sex couple unconstitutional under the equal protection clause of the 14th Amendment as applied to the federal government under the 5th Amendment. *See* United States v. Windsor, 570 US ___, 133 S. Ct. 2675 (2013), *aff'g* 699 F.3d 199 (2nd Cir. 2012). Following *Windsor,* the IRS issued a series of rulings and notices delineating its impact on other taxes, including the income tax. Its first pronouncement was Revenue Ruling 2013-17, 2013-38 IRB 1. This ruling accepted that under *Windsor* all legally married same sex couples will be treated as married for all federal tax purposes. It adopted what is known as the "state of celebration" rule. Under the state of celebration rule, a same sex couple that was lawfully married in a state recognizing same sex marriage is treated as married for federal tax purposes even if they reside in a state that does not recognize same sex marriage. Another issue addressed in Revenue Ruling 2013-17 was the treatment of "registered domestic partners." A number of states have adopted domestic partnership statutes creating a status for same sex couples that is like marriage but not called marriage. The revenue ruling concludes that domestic partners will not be treated as married for federal tax purposes.

Post *Windsor*, the battleground on same sex marriage shifted to the states, many of which have their own DOMAs. Based on *Windsor,* many of those statutes were held unconstitutional by lower courts. The U.S. Supreme Court ruled on that question in 2015, in Obergefell v. Hodges,

576 U.S. ____, 135 S. Ct. 2584 (2015). In the 5-4 decision, the Supreme Court held that state same-sex marriage bans violate both the 14th Amendment's Due Process Clause and Equal Protection Clause. The decision requires all states to grant same-sex marriages and recognize same-sex marriages granted in other states.

A further point to consider is how to treat income earned by registered domestic partners residing in community property states. One could argue that *Poe v. Seaborn* requires income splitting by means of separate returns in such cases. *See* Patricia A. Cain, 111 TAX NOTES 561 (May 1, 2006). Subsequent to a change in California community property law that clarified the community status of income of registered domestic partners, the IRS has agreed that *Poe v. Seaborn* does apply and requires that each partner must report one half of their combined incomes on his or her federal return. Priv. Ltr. Rul. 201021048 (May 5, 2010). For some analysis, see Patricia A. Cain, *Taxation of Domestic Partner Benefits: The Hidden Costs*, 45 UNIVERSITY OF SAN FRANCISCO LAW REVIEW 481 (2010). *See also* Patricia A. Cain, *Planning for Same- Sex Couples in 2011*, ALI- ABA Estate Planning Course Materials Journal, Vol. 17, p. 5, June 2011 (available on SSRN).

For more background in this area see Patricia A. Cain, *DOMA and the Internal Revenue Code*, 84 CHI.- KENT L. REV. 481 (2009). *See also* State Domestic Partnership Laws Present Unanswered Questions, MSP No. 15, Taxpayer Advocate Service, 2010 Annual Report to Congress.

Page 215: In "D. Alternative Minimum Tax," replace the fourth sentence with the following:

It has its own set of rates (26% on the first $175,000 and 28% on the excess), *with brackets that are adjusted for inflation*. It has its own exemption amounts that, beginning in 2012, are *adjusted for inflation*. For 2016, the exemptions amounts were $53,900 for unmarried individuals, $83,800 for married taxpayers filing jointly and surviving spouses, and $41,900 for married taxpayers filing separately. See Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

Page 215: Note that the Example is based on 2013, not 2009, parameters.

Chapter 15:
Tax Credits

Page 222 at the end of the discussion of the Hope Scholarship Credit and the Lifetime Learning Credit add the following paragraph:

The 2015 PATH Act made the previously temporary American Opportunity Tax Credit in section 25(i) permanent. This provision increased the maximum Hope Scholarship credit to $2,500 and made the credit applicable to the first four years of college. It also expanded the definition of qualified tuition and related expenses to include course materials and raised the adjusted gross income thresholds for phase out of the credit. The credit was also made partially refundable. *See* IRC § 25(i)(5).

Page 224: In the third bullet of Related Matters, note the following:

The Tax Increase Prevention Act of 2014 extended through 2014 the section 25C credit for nonbusiness energy property. Congress extended the credit again through 2016. IRC § 25C(g).

Chapter 17:
Capital Gains and Losses

Page 234: In the second paragraph in "5. Determining the Appropriate Capital Gain Rate on "Net Capital Gain," please note the following:

The Tax Increase Prevention Act of 2014 extended through 2014 the section 1202 exclusion of 100% of gain on qualified small business stock. In the 2015 PATH Act Congress made the 100% exclusion permanent.

Page 244: In the Related Matters, add a new bullet point at the end:

Virtual Currency and Characterization. Virtual currency is a recently invented digital medium of exchange. "Bitcoin is one example of a convertible virtual currency. Bitcoin can be digitally traded between users and can be purchased for, or exchanged into, U.S. dollars, Euros, and other real or virtual currencies." Notice 2014-21, 2014-16 IRB 938. One issue concerning this currency is whether it is property for purposes of gain and loss recognition under the code. The IRS has answered that question in the affirmative. *See id*. at Q&A 6. This means, for example, that a person who buys a bitcoin when it was worth $100 and spends it when it is worth $150 would have $50 of gross income when he or she spends the Bitcoin. The character of that gain or loss is determined under the same rules as for any other property. Thus, an investor in Bitcoins could have a capital gain or loss while a dealer in Bitcoins could have an ordinary gain or loss. *Id*. at Q&A 7.

Chapter 28:
Intellectual Property Development and Acquisitions

Pages 364-365: In "3. Section 41 Research Credit for Increasing Research Activities," please note the following:

The Tax Increase Prevention Act of 2014 extended through 2014 the section 41 R&D credit. The 2015 PATH Act made the credit permanent. IRC §41(h)(1).

Page 378: In Related Matters, add the following new bullet:

Domain Names. The IRS recently issued Chief Counsel Advice 201543014, which concluded that a generic domain name is a customer-based intangible as defined in Treas. Reg. 1.197-2(b)(6) if (a) the generic domain name is associated with a website that is already constructed and will be maintained by the purchaser, and (b) such taxpayer acquired the domain name for use in its trade or business. This assumes that the taxpayer is acquiring an already existing site. It does not suggest what would happen if the domain name was purchased from someone who simply owned the name but was not using it.

Chapter 33:
Education Benefits and Costs

Page 444: At the end of "A. Business Education," add the following new material:

For a case holding that a German lawyer could not deduct the cost of obtaining a J.D. from the University of San Diego Law School, *see* O'Connor v. Commissioner, T.C. Memo 2015-155 (Aug. 12, 2015).

Page 445-446: In "1. Deductibility of Interest," note the following:

For 2016, the $2,500 maximum deduction begins to phase out for taxpayers with modified adjusted gross income in excess of $65,000 ($130,000 for joint returns). *See* Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

Page 446 after the first paragraph of "E. Special Credits and Deduction for Qualified Tuition and Related Expenses" add the following:

The 2015 PATH Act made permanent the previously temporary American Opportunity Tax Credit in section 25(i). This provision increased the maximum Hope Scholarship credit to $2,500 and made the credit applicable to the first four years of college instead of just the first two. It also expanded the definition of qualified tuition and related expenses to include course materials and raised the adjusted gross income thresholds for phase out of the credit. The credit was also made partially refundable. *See* IRC § 25(i)(5).

Page 447: At the top of page 447, please note the following:

The Tax Increase Prevention Act of 2014 extended through 2014 the section 222 above-the-line deduction for qualified tuition and related expenses. The 2015 PATH Act extended the deduction through 2016. IRC § 222(e).

Chapter 34:
Personal Injury Recoveries and Punitive Damages

Page 474: In the Related Matters, add new bullet points at the end:

Human Egg Donors. The Tax Court recently concluded that a $20,000 payment received for service as a human egg donor did not constitute amounts received for sale of property. Nor was it excludable from income as a recovery for personal injuries under section 104(a)(2). Instead the payment was taxable as compensation income. Perez v. Commissioner, 144 T.C. 51 (2015).

Recovery for Wrongful Incarceration. The 2015 PATH Act added new section 139F, which provides an exclusion from gross income for certain payments for wrongful incarceration.

Disability Savings. Congress recently enacted new section 529A in the Achieving a Better Life Experience (ABLE) Act. This provision authorizes a tax-favored savings account for long-term disability care. This ABLE account resembles the 529 Account for college savings addressed in Chapter 33. Tax benefits include the exclusion from gross income of earnings on such savings when the funds are used for the benefit of a person who became disabled before reaching age 26. Contributions to these accounts are also excluded from gift tax. The accounts, thus, provide a planning mechanism for parents and other family members to put aside resources for a disabled child. Distributions come out tax free as long as the funds are used for qualified expenses such as education or healthcare. Funds held in these accounts will not disqualify the beneficiary from need based government benefits such as Medicaid. For a detailed discussion, *see* Stephanie R. Hoffer, *Making the Law More ABLE: Reforming Medicaid for Disability*, 76 OHIO STATE L.J. 1255 (2015).

Chapter 42:
Tax Practice and Procedure

Page 573: At the end of "A. Tax Returns," add the following:

The section 6651 penalty for failure to file a tax return or pay tax will be adjusted for inflation after 2014. Tax Increase Prevention Act of 2015, H.R. 5771 (effective for returns filed after December 31, 2014).

Page 574-575: Following the cite to United States v. Home Concrete Supply, insert the following:

In 2015, however, Congress enacted a provision that specifically provides that understating income by overstating adjusted basis triggers the six-year statute of limitations.