Federal Income Tax: Doctrine, Structure, and Policy

TEXT, CASES, PROBLEMS

FIFTH EDITION

2025 SUPPLEMENT

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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), Coronavirus Aid, Relief, Economic Security Act (CARES), Consolidated Appropriations Act, 2021 (2021 CAA), American Rescue Plan Act of 2021 (ARPA) **and most important, the 2025 One Big Beautiful Bill Act** (**OBBBA**).

This is a cumulative update. New material appears in bold type.

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Part One: The Fundamental Structure of the Federal Income Tax

Chapter 1: Taxonomy, History, and the Institutional Structure of Taxation in the United States

Page 12

In spite of some earlier pronouncements by the U.S. Supreme Court suggesting that the realization requirement is merely a statutory principle rather than a constitutional mandate, in *Moore v. U.S.*, **602 U.S. 572** (2024), the Court refused to decide the issue and left the question open to be settled in future litigation.

Page 23

Only eight out of every 10,000 people who died in 2019, the most recent year for which data are available, left an estate large enough to result in a federal estate liability. *See* TaxProf Blog, Dec. 13, 2023.

For estates of decedents dying after 2025, the generally applicable estate tax exclusion amount is $15M, to be indexed for inflation going forward. § 2010(c)(3)(A), as amended by the OBBBA.

Page 33

The exception to *Chevron* applied in *King v. Burwell* has come to be known as "the major questions doctrine." The Supreme Court used it in *West Virginia v. EPA*, 597 U.S. 697 (2022), to invalidate a regulation designed to effect a nation-wide shift of electric power generation to cleaner emission sources.

In a pair of recent cases, *Becerra v. Empire Health Found.*, 597 U.S. 424 (2022), and *American Hospital Ass'n v. Becerra*, 596 U.S. 724 (2022), the Supreme Court ruled on the validity of two different Medicare regulations promulgated by the U.S. Department of Health and Human Services. The Court declared invalid the regulation involved in *American Hospital Ass'n* while the regulation at issue in *Empire Health* was upheld. In each case, the Court decided the matter by making its own determination of whether the regulation in question was the "best" interpretation of the underlying statue. The major questions doctrine was not invoked in either case and neither opinion applied or even cited *Chevron*, not even in a footnote. On the other hand, it was not expressly overruled. The result was continuing uncertainty regarding *Chevron* **that was resolved in *Loper Bright* (discussed below).**

Pages 30-32

In *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024), the Supreme Court overruled *Chevron*. The usual standard of judicial deference for Treasury Regulations apparently is now provided by the *Skidmore* decision that is explained at casebook page 34. However, *Loper Bright* indicates that if the relevant statute expressly delegates to an agency authority

to define a particular term, supply the details of a statutory scheme, or regulate subject to statutory limits that permit flexibility, and if the terms of the delegation are limited by an intelligible standard, then the court will uphold a regulation promulgated under such authority if the regulation falls within the parameters of the delegation and is the product of reasoned decision making. Whether § 7805(a) is, or is not, such an express delegation is presently an unanswered question. *See* Mitchell M. Gans, *Has the Supreme Court Already Resolved How Loper Bright Applies to Section 7805 Regulations?*, 187 Tax Notes Fed. 1069 (2025). Nevertheless, when the major question doctrine (articulated in *King v. Burwell* and explained at casebook page 33) applies, it allows the courts to deny deference to Treasury regulations and to engage in denovo analysis of the issues dealt with in a regulation.

Page 37, note 37

In *Crim v. Comm'r*, **66 F.4th 999** (D.C. Cir. 2023), the D.C. Circuit re-affirmed its *Kuretski* holding that the President's power to remove Tax Court judges for good cause does not violate the separation of powers principle of the U.S. Constitution. The *Crim* opinion also stated that the purpose of the 2015 amendment to § 7441 was "'only to ensure that there is no appearance of institutional bias' when the Tax Court adjudicates **disputes** between the IRS and taxpayers." **66 F.4th at 1001 (quoting from S. Rep. No. 114-14).**

Chapter 2: The Fundamental Structure of the Federal Income Tax

Page 71

The Rates

The 2017 TCJA income tax rates for individuals, estates, and trusts were supposed to expire at the end of 2025 and revert to earlier, higher rates. However, the OBBBA permanently extended the 2017 TCJA rates to all years after 2025. Section 1(f) requires that these rates be adjusted annually to reflect inflation. Rev. Proc. 2024-40, 2024-45 I.R.B. 1100, prescribes the inflation-adjusted rates that apply in 2025.

Page 74

The 2017 TCJA's suspension of the personal and dependency exemption deductions for the years 2018 through 2025 was made permanent for all future years by the OBBBA.

Pages 75-76

The OBBBA provides that the standard deduction amounts for 2025 are $31,500 for joint filers, $23,625 for heads of households, and $15,750 for single individuals and marrieds filing separately. These amounts, to be adjusted for inflation for years after 2025, apply to all future years (so the increased standard deduction provided by the 2017 TCJA was made permanent and enlarged by the OBBBA).

The OBBBA makes the 2018-2025 disallowance of MIDs permanent for all years after 2025

but changes the classification of certain educator expenses (defined in new § 67(g)) from MIDs to itemized deductions that can be claimed if the standard deduction is forgone. *See* § 67(b)(13), as added by the OBBBA.

The § 68 cut-down of itemized deductions was permanently repealed by the OBBBA and replaced by a new § 68 limitation that requires a taxpayer's total allowable itemized deductions to be reduced by 2/37 of the lesser of (1) the total allowable itemized deductions or (2) the amount of otherwise taxable income that falls into the taxpayer's 37% bracket. This 2/37 reduction is only relevant for taxpayers with income in the 37% bracket and its effect is to ensure that the tax saving from $1.00 of itemized deduction will never exceed $0.35. This provision obviously increases the complexity of the income tax system for high-income itemizers (arguably appropriately so).

Page 77

Section 199A was scheduled to expire at the end of 2025. The OBBBA has extended (and enlarged) it permanently.

Page 78

For 2026 and later years, the OBBBA generally adopted the individual AMT's 2017 TCJA exemption amounts and increased the phaseout range above the amount provided by the 2017 TCJA.

Pages 78-79

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. In Notice 2021-21, 2021-15 I.R.B. 968, the IRS extended the due date for 2020 individual returns to May 17, 2021. No interest or penalties were assessed on any tax payments that were paid in full by either postponed due date.

Chapter 4: Rates and Allowances for Basic Maintenance

Pages 101-02

The OBBBA makes § 199A permanent so that it does not expire at the end of 2025. It also somewhat enlarges it.

Page 104

The Respect for Marriage Act, which became effective on December 13, 2022, repealed the Defense of Marriage Act.

Page 106

The inflation-adjusted tax rate schedules for 2025 can be found in *Rev. Proc. 2024-40,* 2024-45 I.R.B. 1100.

Page 110

The OBBBA provides that the standard deduction amounts for 2025 are $31,500 for joint filers, $23,625 for heads of households, and $15,750 for all other filers. These amounts, adjusted for inflation for years after 2025, apply to all future years. The modest additional deduction for 65 or older and/or blind taxpayers continues to apply.

Pages 110-11

The 2017 TCJA's suspension of the personal exemption deduction, which was scheduled to expire after 2025, has been made permanent by the OBBBA for 2026 and all future years. However, this development is partially mitigated by the OBBBA's addition of new temporary § 151(d)(5)(C), which gives 65 or older taxpayers a $6,000 deduction for each of the years 2025-2028. The deduction phases out as modified adjusted gross income rises above a statutory threshold. It appears that this is a specially treated below-the-line deduction that is allowed in addition to the standard deduction if the taxpayer does not itemize deductions, but the statutory language is not clear.

Pages 111-17

The 2017 TCJA's decrease of the dependency exemption deduction to zero was scheduled to expire at the end of 2025. However, the OBBBA has made the reduction permanent for all years after 2025. Thus, the Problem at pages 116-17 is now obsolete.

Pages 117-18

The OBBBA permanently increased the maximum child tax credit to $2,200 per qualifying child for 2025, with this amount to be inflation adjusted for all future years after 2025. Beginning in 2026, the OBBBA increases the maximum child and dependent care credit from 35% of qualifying expenses to 50% of such expenses and provides that the phaseout is more gradual. But the $3,000 and $6,000 limitations on qualifying expenses are retained.

Section 63(c)(5) is unaffected by the OBBBA. The 2025 standard deduction amounts for an individual claimed as a dependent cannot exceed the greater of $1.35K or $450 plus the individual's earned income. *See Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100. The 2025 regular

standard deduction for unmarried individuals and married filing separately filers is $15,750, as increased by the OBBBA.

Page 119

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

The credit **was** phased out by $5 for every $100 over certain adjusted gross income thresholds ($150K for joint-filers, $112.5K for head-of-household filers, and $75K for all other taxpayers). Therefore, individuals without any "qualifying children" did not receive an advance payment if their 2019 (or 2018) adjusted gross income was $198K, $136.5K, and $99K, respectively.

2021 CAA added § 6428A to the Code. This gave "eligible individuals" Additional Recovery Rebate Credits for 2020 of $1.2K for joint filers, and $600 for others, plus $600 for each qualifying child. Consistent with the first Recovery Rebate Credit, the credit phased out by $5 for every $100 over certain adjusted gross income thresholds ($150K for joint filers, $112.5K for head-of-household filers, and $75K for all other taxpayers). Therefore, individuals without any "qualifying children" were phased out of the Additional Recovery Rebate Credit if their adjusted gross income was equal to or greater than $174K (joint filers), $124.5K (heads-of-household), and $87K (all others). In response to criticism regarding the first Recovery Rebate Credit, Congress clarified that to receive the credit an individual had to be alive on January 1, 2020, and expanded the coverage to include joint filers if at least one spouse had a valid-for-work Social Security number.

ARPA added § 6428B to the Code. This allows eligible individuals a 2021 Recovery Rebate Credit. The maximum credit is $2.8K for joint filers and $1.4K for most other individuals, plus an additional $1.4K for each dependent. The credit is completely phased out at $160K AGI for joint filers and surviving spouses, $120K AGI for heads-of-household filers, and $80K AGI for other individuals. In response to criticism regarding the first two Recovery Rebate Credits, Congress expanded the credit coverage to include all dependents under § 152 instead of only qualifying children. For this purpose, dependents include dependents of filers who do not have valid-for-work Social Security numbers.

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

Page 131

The OBBBA temporarily increases the $10K deduction ceiling for taxes as follows: to $40K for 2025, to $40.4K for 2026 with 1% annual increases through 2029, and reversion to $10K for 2030 and subsequent years. If the taxpayer's modified adjusted gross income exceeds $500K for 2025 or incrementally increasing amounts for years 2026 through 2029, a phaseout will apply to the deduction ceiling but the ceiling will not go below $10K.

Pages 137-39

The deduction allowed by § 212(3) is a miscellaneous itemized deduction. All such deductions were disallowed through 2025 by the 2017 TCJA and have been permanently disallowed for 2026 and all future years by the OBBBA. Therefore, the material at pages 137-39 is now obsolete except to the extent a tax professor wishes to have students consider the policy questions raised therein.

Page 140

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). The 2021 CAA made the 7.5% floor permanent.

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

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

The OBBBA provides that 100% of the cost (after reduction by any §179 write-offs) of eligible property acquired after January 19, 2025, is deductible under § 168(k) for the taxable year in which the property is placed in service. This essentially makes the § 168(k) 100% bonus depreciation/expensing for most types of depreciable tangible personal property a "permanent" fixture of the federal income tax system.

The OBBBA also enacted a new § 168(n) that also provides a 100% expense deduction for the cost of qualified production property the construction of which starts after January 19, 2025, and before 2029 and which is placed in service in the United States or a U.S. possession (e.g., Puerto Rico and the Virgin Islands) after July 4, 2025, and before 2031. This is a defined class of depreciable business nonresidential real property (i.e., the depreciable building but not the underlying nondepreciable land) used in the manufacturing, production, or refining of a "qualified product," which is generally any tangible personal property other than food or beverages prepared and sold in the same building. "Qualified production property" for this purpose does not include the portion of real property that is used for offices, administrative services, lodging, parking, sales activities, research activities, software development or engineering activities, or other functions that are unrelated to manufacturing, producing, or refining tangible personal property. This limitation could

raise some challenging allocation issues for determining what portion of the cost of a depreciable building qualifies for this deduction.

Page 169

The OBBBA adopted a new savings vehicle called the "Trump account." It is roughly analogous to a Roth IRA savings arrangement but it permits a broader range of contributors and broader withdrawal opportunities.

New § 530A states that a Trump account is an individual retirement account "which is not designated as a Roth IRA." This implies that contributions to the account are deductible. Nevertheless, new § 530A(c) states that contributions are not deductible if "made before the first day of the calendar year in which the account beneficiary attains age 18" and withdrawals attributable to those non-deductible contributions are not taxable. Thus, until the year in which the account beneficiary turns 18, a Trump account resembles a Roth IRA on important points.

In simplified terms, a Trump account can only be established for an individual who has not yet reached age 18 but the account can be established by anyone, regardless of relationship, or lack thereof, to the beneficiary. Multiple parties, regardless of relationship, or not, to the beneficiary, can contribute to the account but total annual contributions cannot exceed a $5K ceiling, indexed for inflation starting in 2028. When the beneficiary reaches 18, contributions thereafter are deductible and distributions attributable thereto are taxable as ordinary income. The federal government will make one $1K tax-free contribution to the Trump account of each beneficiary born in 2025-2028. This contribution will not count against that year's contribution cap.

Contributions are held in trust and must be invested in certain conservative, low-cost vehicles. The trust is tax-exempt.

No withdrawals or distributions can be made before the beneficiary turns 18 but thereafter, withdrawals and distributions by or for the beneficiary can be made for any purpose. However, withdrawals or distributions before age 59½ result in the early withdrawal penalties that apply to IRAs.

The preceding description glosses over the technical details but is sufficient to show that the consumption tax approach applies to Trump accounts. The details are properly reserved for an advanced course.

Pages 170-71

The OBBBA provides that the maximum amount a taxpayer can expense under § 179 for taxable years beginning after 2024 is increased from $1M to $2.5M, reduced by eligible

property placed in service during the year in excess of $4M. These amounts are inflation adjusted after 2025. Thus, at $6.5M of eligible property placed in service in 2025, taxpayers will not be eligible for any § 179 deduction.

Page 175

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" (ATI) for 2019 and 2020. Moreover, given the economic challenges in 2020, taxpayers could elect to use 2019 adjusted taxable income in lieu of 2020 adjusted taxable income pursuant to § 163(j)(10).

The business interest expense limitation of 50% was never extended. Therefore, for tax years 2021 and thereafter, the business interest expense limitation is 30% of ATI (and depreciation, amortization, and depletion are no longer added back in computing ATI after 2021). Nevertheless, § 163(j) does not apply for 2025 to any business (other than a tax shelter) whose average annual gross receipts for the three years ending with the preceding tax year do not exceed $31M. *See* §§ 163(j)(3), 448(c); *Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100. The OBBBA liberalized the computation of ATI after 2024, thereby indirectly increasing the 30% limitation.

Chapter 7: The Capitalization Principle in Practice

Page 188

The TCJA provides that beginning after December 31, 2021, research and experimentation costs must generally be capitalized and amortized over five years with respect to research conducted in the United States and 15 years with respect to foreign research. IRC § 174(a). **Effective for years after 2024, the OBBBA has amended § 174(a) so that it is limited to providing that the only write-off for foreign research or experimental expenditures is 15-year amortization. Effective for the same years, the OBBBA adopts a new § 174A which allows domestic research and experimental expenditures to be fully deducted in the year when paid or incurred. Alternatively, § 174A permits the taxpayer to elect amortization over not less than 60 months in place of a full current deduction.**

For taxable years beginning in 2025, a taxpayer (other than a tax shelter) meets the § 448(c) gross receipts test for avoiding § 263A under § 263A(i) if its average annual gross receipts for the three-year period ending with the preceding tax year do not exceed $31M. *See Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100

Page 200

The TCJA provides that beginning after December 31, 2021, research and experimentation costs must generally be capitalized and amortized over five years with respect to research conducted in the United States and 15 years with respect to foreign research. IRC § 174(a). **Effective for years after 2024, the OBBBA has amended § 174(a) so that it is limited to providing that the only write-off for foreign research or experimental expenditures is 15-year amortization. Effective for the same years, the OBBBA adopts a new § 174A which allows domestic research and experimental expenditures to be fully deducted in the year when paid or incurred. Alternatively, § 174A permits the taxpayer to elect amortization over not less than 60 months in place of a full current deduction.**

Page 202

See page 200 of this Update Memorandum regarding full immediate deduction provided by the OBBBA in new § 174A for domestic research and experimental expenditures.

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

Chapter 8: The Basic Framework Governing Business and Investment Deductions

Pages 216-17

The OBBBA makes the 2018-2025 disallowance of MIDs permanent for all years after 2025.

Pages 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. The safe harbor applies to all years after 2017.

Page 219

An employee's business bad debt deduction under § 166(a) is an MID that is disallowed for years after 2017 by redesignated § 67(h). Section 67(h), which was enacted as § 61(g) by the 2017 TCJA, was scheduled to expire after 2025, but the OBBBA made the disallowance permanent.

Page 228

Section 199A was permanently extended (and somewhat expanded) by the OBBBA.

Chapter 9: Defining the Personal Realm: Of Human Capital

Page 251

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. The 2021 CAA repealed § 222 for years after 2020. 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. The 2021 CAA extended this through the end of 2025 **and the OBBBA made the extension permanent. § 127(c)(1)(B).** However, Congress did not increase the overall cap of $5,250, **but it is inflation indexed for years after 2026.**

Page 254

The OBBBA makes the suspension of § 217 (scheduled to end after 2025) permanent but provides that § 217, nevertheless, applies to qualifying moving expenses of certain members of the intelligence community and the armed forces. The suspension of the exclusion in § 132(a)(6) and § 132(g)(2) for a qualified moving expense reimbursement receives identical treatment by the OBBBA, but certain members of the intelligence community and the armed forces continue to qualify for the exclusion.

Page 256

See page 254 of this Update Memorandum regarding § 217.

Chapter 10: Dual-Purpose Outlays

Page 259

In *Gregory v. Comm'r*, T.C. Memo 2021-115, the Tax Court held that the § 183(b)(2) deduction is a miscellaneous itemized deduction subject to the § 67(a) two-percent floor. (Recall that for tax years starting after 2017, **as a result of the 2017 TCJA and the OBBBA,** § 67 is a complete disallowance rule.)

Page 269

In Chief Counsel Advice Memorandum 202111012, February 16, 2021, the IRS Chief Counsel concluded that the 2017 TCJA amendment to § 165(d) applies only to individual gamblers and not to entities, such as casinos, engaged in the business of gambling. Under *Mayo v. Comm'r*, 136 T.C. 81 (2011), those entities can deduct § 162 trade or business expenses that are not the direct cost of the wager itself.

Effective for years after 2025, the OBBBA made the 2017 TCJA amendment to § 165(d) (treating any otherwise allowable deduction incurred in carrying on any wagering transaction as a wagering loss) permanent. Effective for years after 2025, the OBBBA also amended § 165(d) to provide that a deduction for wagering losses during any tax year is (1)

limited to 90 percent of the amount of the wagering losses during the year and (2) allowed only to the extent of gains from wagering transactions (a limitation that has been in the statute for many years).

Page 275

The 2021 CAA makes the 50% limitation under § 274(n)(1) inapplicable to expenses paid or incurred after 2020 and before 2023 for food or beverages provided by a restaurant. For this purpose, Notice 2021-25, 2021-17 I.R.B. 1, defined a restaurant as a business that "prepares and sells food or beverages to retail customers for immediate consumption" regardless of whether the consumption occurs on the businesses' premises. Beer, wine, or liquor stores; vending machines; newsstands; drugstores; kiosks; specialty food stores; grocery stores; convenience stores; and employer-provided dining facilities were excluded from the foregoing definition. Because Congress did not extend this provision, the 50% reduction is again applicable beginning in 2023.

Chapter 11: Allocating Costs Between the Income Production and Personal Realms

Pages 294, 301

The 2021 CAA makes the 50% limitation under § 274(n)(1) inapplicable to expenses paid or incurred after 2020 and before 2023 for food or beverages provided by a restaurant. For this purpose, Notice 2021-25, 2021-17 I.R.B. 1, defined a restaurant as a business that "prepares and sells food or beverages to retail customers for immediate consumption" regardless of whether the consumption occurs on the businesses' premises. Beer, wine, or liquor stores; vending machines; newsstands; drugstores; kiosks; specialty food stores; grocery stores; convenience stores; and employer-provided dining facilities were excluded from the foregoing definition. Because Congress did not extend this provision, the 50% reduction is again applicable beginning in 2023.

PART FOUR: GROSS INCOME FROM MARKET TRANSACTIONS

Chapter 12: Forms of Compensation Income

Page 319

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). The 2021 CAA extended this through the end of 2025. **For years after 2025, the OBBBA made this extension permanent and indexed the $5,250 limitation for inflation after 2026.**

Page 323

On the campaign trail, President Trump promised to make tip income non-taxable. The OBBBA adopted a new temporary § 224 that is less expansive than the campaign promise.

Effective only for years 2025-2028, individuals are allowed to annually deduct up to $25K of tip income (qualified tips) which is:

> **Received in cash by an individual in a work setting where tips were regular and customary on or before December 31, 2024 (tips charged on a credit card and tips received by an employee under any tip-sharing arrangement are cash tips for this purpose);**
> **Paid voluntarily by the payor in an amount determined by the payor; and**
> **Received for work in the course of a trade or business that is not a § 199A(d) specified trade or business.**

The deduction gradually phases out as modified adjusted gross income increases above $150K ($300K for a joint return), for example, the deduction disappears entirely at modified adjusted gross income of $400K in the case of a single individual who otherwise would be entitled to a $25K deduction. The § 224 deduction is a specially treated below-the-line deduction that can be taken in addition to the standard deduction if the taxpayer does not itemize deductions.

President Trump also promised on the campaign trail to make overtime pay non-taxable. The less-expansive response is found in new temporary § 225 which, for years 2025-2028, allows individuals to deduct up to $12.5K ($25K in case of a joint return) of overtime pay, but only if it exceeds the individual's regular compensation, is not tip income covered by § 224, and qualifies as required overtime pay under Section 7 of the Fair Labor Standards Act of 1938 (i.e. the "half" of "time and a half). Workers not covered by the FLSA are ineligible for the deduction. The deduction gradually phases out as modified adjusted gross income exceeds $150K. Thus, in the case of a single individual otherwise entitled to deduct $12.5K, the deduction is entirely lost when modified adjusted gross income reaches $275K. The § 225 deduction is a specially treated below-the-line deduction that can be taken in addition to the standard deduction if the taxpayer does not itemize deductions.

Consider the disparate treatment of married individuals A, B, C, and D who file joint returns on which the only gross income is personal compensation income of $60,000 per year (which is below the phaseout ranges for those deductions) and is composed of the following elements:

- **A- 100% ordinary wage income**
- **B- 30% tip income that qualifies for the § 224 deduction and 70% ordinary wage income**
- **C- 30% overtime pay that qualifies for the § 225 deduction and 70% ordinary wage income**
- **D- 30% tip income that qualifies for the § 224 deduction, 30% overtime pay that qualifies for the § 225 deduction, and 40% ordinary wage income**

Does any of this make sense from a tax policy point of view?

PART FIVE: WEALTH TRANSFERS

Chapter 14: Recoveries for Personal Injury and Other Windfall Receipts

Page 356

In *Blum v. Comm'r*, T.C. Memo. 2021-18, the taxpayer indisputably suffered a personal physical injury but she lost the suit for damages that she brought against the alleged tortfeasor. She then sued her attorneys for malpractice and received a $125K settlement which she excluded under § 104(a)(2) on the theory that the settlement was a substitute for the personal physical injury judgment she would have received if her attorneys had not mishandled the case. The court held that the settlement award was not received on account of a personal physical injury because the pleadings in the taxpayer's suit against the lawyers framed the action as a lawyer malpractice case as did the settlement agreement. Might the taxpayer have achieved a § 104(a)(2) exclusion if the pleadings and settlement agreement had used language consistent with the "substitute for personal injury judgment" theory? Alternatively, the taxpayer argued that she could exclude the malpractice recovery as a loss reimbursement under *Clark v. Comm'r*, infra page 704. The court held that *Clark* and similar reimbursement cases did not apply because the settlement payment compensated the taxpayer for her lawyer's professional failure rather than for the loss of the speculative amount she might have received if she had won her personal injury suit. The court did not discuss whether the taxpayer had any basis to offset against the settlement amount. Did she?

Page 357

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).

Pages 360-63

If a plaintiff does not qualify for relief under § 62(a)(20) and the plaintiff's attorneys' fees are deductible under either § 162 (as an unreimbursed employee business expense) or § 212 (1) (as an expense for the production or collection of taxable income from a personal injury award that is not excludable under § 104), the deduction generally will be an MID disallowed by § 67 for taxable years after 2017. The § 67 disallowance of MIDs was scheduled to expire after 2025, but the OBBBA has made the disallowance of MIDs permanent.

Chapter 15: Gratuitous Transfers

Page 390

In IR-2021-70 (March 30, 2021), the IRS announced that "Emergency financial aid grants made by a federal agency, state, Indian tribe, higher education institution or scholarship-granting organization (including a tribal organization) to a student because of an event related to the COVID-19 pandemic are not included in the student's gross income."

Notice 2023-56, 2023-38 I.R.B. 824 states that "[t]o qualify for the general welfare exclusion, State payments must (1) be paid from a governmental fund, (2) be for the promotion of general welfare (that is, based on the need of the individual or family receiving such payments), and (3) not represent compensation for services absent a specific Federal income tax exclusion."

Page 400

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 enactment of the CARES Act (March 27, 2020) through December 31, 2020. § 127(c)(1)(B). The 2021 CAA extended this through the end of 2025. **The OBBBA made this extension permanent for years after 2025 and indexed the $5,250 limitation for inflation after 2026.**

Chapter 16: Charitable Contributions

Page 403

Congress added § 62(a)(22) in the CARES Act, providing an above-the-line charitable deduction of up to $300 ($150 if married filing separately) for cash donations to qualifying public charities for 2020. The 2021 CAA extended this to **only** 2021 **as a specially treated below-the-line deduction in new § 170(p) (not as an above-the-line deduction)** but increased the limit for married filing jointly filers to $600 ($300 for unmarried and married filing separately filers).

Effective for years after 2025, the OBBBA added a revised § 170(p) which allows non-itemizers to annually deduct up to $1,000 ($2,000 for a joint return) for the aggregate sum of cash contributions to § 170(b)(1)(A) organizations (except § 509(a)(3) private foundation support organizations). This provision is listed in § 63(b)(4) as a specially treated below-the-line deduction that can be taken in addition to the standard deduction.

Page 407

The Further Consolidated Appropriations Act of 2019, Pub. L. No. 116-94, reduced the § 4940(a) tax on the net investment income of private foundations from 2% to 1.39%.

IRS Chief Counsel Memorandum AM 2023-004 (June 9, 2023), stated that "[a]n organization that develops paid NIL [name, image, and likeness] opportunities for student-athletes will, in many cases, be operating for a substantial nonexempt purpose – serving the private interests of student-athletes. … Consequently, … many organizations that develop paid NIL opportunities for student-athletes are not tax exempt….”

Page 408

For years after 2026, the OBBBA added a new § 25F, which allows a credit (limited to $1.7K) for cash contributions to certain scholarship granting organizations in states that elect to participate.

Page 412

Section 170(b)(1)(G) had provided that for the years 2018-2025, the limitation on aggregate cash contributions to § 170(b)(1)(A) organizations was 60% of the taxpayer’s contribution base. The OBBBA provides that after 2025, a taxpayer’s cash contributions to § 170(b)(1)(A) organizations for a year are deductible to the extent such contributions do not exceed 60% of the taxpayer’s contribution base, after this base has first been reduced by the total amount of all of the taxpayer’s contributions (cash and non-cash) to such organizations for the year.

For years after 2025, the OBBBA added a new § 170(b)(1)(I) specifying that individuals cannot claim any otherwise allowable § 170 deductions except to the extent that the taxpayer’s aggregate of such deductions for the year exceeds 0.5% of the taxpayer’s contribution base for the year. There is a limited carryover of deductions disallowed by this floor.

The CARES Act allowed 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).

One recent study found that individual donations to colleges and universities had declined by four percent in the two years following the effective date of the 2017 TCJA’s substantial standard deduction increase and reduction in marginal tax rates. *See* Jin Lee, *Trump-Era Tax Cuts Contributed to a Decline in Higher Ed Giving*, CHRONICLE OF PHILANTHROPY (Mar. 29, 2024), available at philanthropy.com/article/trump-era-tax-cuts-contributed-to-a-decline-in-higher-ed-giving.

Chapter 17: Income-Shifting Strategies

Page 430

In Notice 2020-46, 2020-27 I.R.B. 7, the holdings in Notice 2014-68 were applied to employee waivers of vacation, sick, or personal leave in exchange for employer cash contributions made before January 1, 2021, to § 170(c) organizations for the relief of COVID-19 pandemic victims in specified geographical areas.

In Notice 2022-28, 2022-23 I.R.B. 1182, the IRS applied the holdings in Notice 2014-68 to employee waivers of vacation, sick, or personal leave in exchange for employer cash contributions made before January 1, 2023, to § 170(c) organizations to aid victims of the 2022 invasion of Ukraine.

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 could 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

Pages 468-69

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" (ATI) for 2019 and 2020. Moreover, taxpayers could 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 likely provided a larger 2020 business interest deduction for many taxpayers. **The business interest expense limitation of 50% was never extended. Therefore, the limit for 2021 and subsequent years is 30% of ATI (and depreciation, amortization, and depletion are no longer added back in computing ATI after 2021).**

Section 163(j) does not apply for 2025 to any business (other than a tax shelter) whose average annual gross receipts for the three years ending with the preceding tax year do not exceed $31M (indexed for inflation in future years). *See* §§ 163(j)(3), 448(c); *Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100.

Page 472

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. The 2021 CAA extended this treatment of qualified mortgage insurance premiums through 2021.

Interest on automobile purchase loans has been deductible by individuals since 1986 as an itemized deduction (but not an MID) if the debtor satisfied the home equity indebtedness interest requirements in § 163(h)(3), which were temporarily suspended by the 2017 TCJA and have now been permanently suspended by the OBBBA. Effective for years 2025-2028, however, the OBBBA adopted new § 163(h)(4) which allows individuals a deduction for "qualified passenger vehicle loan interest." This term is the subject of a detailed and technical definition but qualified passenger vehicle loan interest is generally interest on debt owed to an unrelated party and incurred to purchase a new personal use vehicle, assembled in the United States, with the loan being secured by a first lien on the vehicle. However, the aggregate amount of interest deductible in a year with respect to all of the taxpayer's qualifying debt on such vehicles is capped at 10K (not inflation adjusted), and the deduction is gradually phased out as modified adjusted gross income for the year exceeds $100K ($200K for joint returns). This provision is listed in § 63(b)(7) as a specially treated below-the-line deduction that can be taken in addition to the standard deduction by taxpayers who do not itemize deductions.

Page 473

The OBBBA made permanent the $750K cap ($375K for marrieds filing separately) on home acquisition debt that was temporarily imposed by the 2017 TCJA but scheduled to expire after 2025. The 2017 TCJA's suspension of the deduction for home equity indebtedness interest (which was scheduled to expire after 2025) was also made permanent by the OBBBA.

Chapter 19: Cancellation-of-Debt Income

Page 497

The OBBBA amended § 108(e)(5) to make permanent, for years after 2025, the inclusion of discharges because of the student's death or permanent and total disability.

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. *See Rev. Proc. 2015-57*, 2015-51 I.R.B. 863; *Rev. Proc. 2017-24*, 2017-7 I.R.B. 916.

Page 504

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. The 2021 CAA extended § 108(a)(1)(E) to cover cancellations before 2026.

PART SEVEN: REALIZATION AND RECOGNITION

Chapter 20: Debt and Property

Page 518

In *Howland v. Comm'r,* T.C. Memo 2022-60 (2022), petitioners had first and second mortgage debt on their personal residence. Petitioners defaulted on both debts and the lenders foreclosed. The sale proceeds satisfied the first mortgage debt. Sale proceeds received by the second mortgage creditor were less than the total amount owed but more than the unpaid interest. The terms of the second mortgage debt specified that petitioner's payments would be applied first to unpaid interest. Petitioners, cash method taxpayers, claimed the interest due on the second mortgage as a qualified residence interest expense deduction in the year of the foreclosure sale. Petitioners did not receive an interest expense information return from the second mortgage lender and there was no other evidence that the lender had applied any of its sales proceeds to petitioner's unpaid interest. The Tax Court held that in spite of the payment allocation term in the debt agreement, petitioners had failed to prove that any qualified residence interest had been paid and, therefore, no deduction was allowable.

In *Milkovich v. U.S.*, 24 F.4th 1 (9th Cir. 2022), taxpayers filed for bankruptcy and after the discharge their personal residence was subject to nonrecourse debt. The taxpayers defaulted and the creditor agreed to a third-party sale in an arm's-length transaction at a price less than the amount of the unpaid debt. The creditor received the sale proceeds, and the nonrecourse debt was extinguished. The creditor gave the taxpayers an interest expense information return for the amount it allocated to the accrued interest. The taxpayers, apparently using the cash method, deducted the interest accrued as qualified residence interest expense paid in the year of the sale. The Ninth Circuit applied the Tax Court's analysis in *Catalano v. Comm'r*, supra, to allow the deduction.

Chapter 23: Tax Accounting Methods

Page 593

For 2025, a corporation or partnership (other than a tax shelter) whose average annual gross receipts for the three years ending with the preceding tax year do not exceed $31M (as indexed for inflation) may use the cash method of accounting and are excused from inventory accounting. *See* §§ 448, 471; *Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100.

Chapter 24: Realization of Loss on the Destruction or Theft of Property

Pages 641-46

Section 165(h)(5), which was added by the 2017 TCJA, allows the deduction of personal casualty losses that are not attributable to a federally declared disaster only to the extent of personal casualty gains in the same taxable year. It was scheduled to expire after 2025, but the OBBBA has made that provision permanent. For years after 2025, the OBBBA amended § 165(h)(5) to extend the more favorable treatment of personal casualty losses from federally declared disasters to include personal casualty losses attributable to a state declared disaster. The OBBBA's permanent extension of § 165(h)(5) makes the material on these pages less important.

Chapter 25: Capital Gains and Losses

Pages 677-78

The OBBBA amended § 1202 to provide that for qualified stock acquired after July 4, 2025, the gain exclusion is 50% for stock held at least 3 years, 75% for stock held at least 4 years, and 100% for stock held at least 5 years.

PART EIGHT: CAPITAL RECOVERY

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

Page 690

The inflation-adjusted amounts for 2025 for the 15% capital-gains rate ranges for individuals are as follows: taxable income more than $96.7K, but not more than $600.05K, for joint-filers; more than $64.75K, but not more than $566.7K, for head-of-household filers; more than $48.35K, but not more than $300K, for married filing separately filers; and more than $48.35K, but not more than $533.4K for single filers. The capital-gains rate of individual taxpayers with taxable incomes equal to and below the initial threshold ranges for 2025 is 0% and the capital-gains rate of individual taxpayers with taxable incomes above those ranges for 2025 is generally 20%. *See Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100.

Pages 698-99

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. In ARPA, Congress extended the "excess business loss" limitation for non-corporate taxpayers under § 461(l) through 2026. The 2022 IRA further extended the disallowance of excess business losses for any tax year beginning before January 1, 2029. Therefore, the combined effect is that excess business losses of noncorporate taxpayers are disallowed from 2021 through 2028. **However, the OBBBA has now made this loss limitation permanent. For taxable years after 2018, the $250K or $500K thresholds are adjusted for inflation and are $313K ($626K for joint returns) for 2025. *See Rev. Proc.* 2024-40, 2024-45 I.R.B. 1100.**

For contracts entered into in 2025, the gross receipts ceiling for using the completed-contract method is $31M. *See Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100.

Page 703

In *Anikeev v. Comm'r*, T.C. Memo. 2021-23, the joint filer taxpayers used two American Express cards to make purchases exceeding $6M over a two-year period. These resulted in card rewards of more than $300,000. Most of these card rewards were used to make American Express card purchases of (1) Visa gift cards that were promptly used to buy money orders that were then deposited in the taxpayers' bank accounts, (2) money orders that were deposited into taxpayers' bank accounts, and (3) cash infusions to reloadable debit cards. The IRS contended that the entire amount of card rewards was includable in gross income when issued by American Express because the rewards were rebates used to acquire cash equivalents and the purchase price adjustment approach illustrated in Rev. Rul. 76-96 is inapplicable to such purchases. Rev. Rul. 76-96 requires a basis reduction and the IRS asserts that cash equivalents must always have a basis equal to face amount. The taxpayers argued that the Rev. Rul. 76-96 and similar authorities made the card rewards totally excludable regardless of how they were used. The Tax Court held: (1) Visa gift cards are a product so that the principle in Rev. Rul. 76-96 made card rewards used to make American Express card purchases of Visa gift cards excludable, although basis in the gift cards had to be reduced to reflect the exclusion so that the taxpayers would have includable gains to the extent that the prices of future purchases with the gift cards exceeded the taxpayers' basis therein and (2) Rev. Rul. 76-96 was inapplicable to card rewards used to make direct American Express card purchases of money orders or cash infusions into reloadable debit cards. Those card rewards were includable in income when credited to the taxpayers' American Express card accounts.

Students might be interested in the underlying economics of the taxpayers' American Express card transactions. Virtually all of the more than $6M of card purchases were ultimately for purchases of money orders that were promptly deposited in the taxpayers' bank accounts from which the card charges were subsequently paid. Thus, the credit card purchases and the payments of card balances were essentially a circular flow of money that had no net cost to the taxpayers, except for small credit card fees and transaction expenses, but that produced a "return" of more than $300K of card rewards. The IRS asserted that this return was fully taxable when the card rewards were credited to the taxpayers' card accounts. The taxpayers argued that the rewards were tax-free rebates. The Tax Court made the bifurcated ruling explained above.

Pages 719-20

In *Mihelick v. U.S.*, 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). **As discussed above, the OBBBA makes the 2018-2025 disallowance of MIDs permanent for all years after 2025.**

Page 722

In response to a global pandemic and stay-at-home orders across America, which applied to many IRS employees, Congress (in the CARES Act) automatically postponed the due date for filing 2019 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. In Notice 2021-21, 2021-15 I.R.B. 986, the IRS extended the due date for 2020 individual returns to May 17, 2021. No interest or penalties were assessed on any tax payments that were paid in full by the postponed due dates.

Page 723

See William C. Boning, Nathaniel Hendren, Ben Sprung-Keyser & Ellen Stuart, *A Welfare Analysis of Tax Audits Across the Income Distribution* (National Bureau of Economic Research Working Paper 31376, June 2023) (finding that on average for the 2010-2014 period, $1 spent by the IRS on auditing yielded $2.17 in revenue but that audits of taxpayers in the 99-99.9th income percentile yielded $3.20 per dollar of IRS audit cost and audits of the top 0.1% of taxpayers yielded $6.30 per dollar of IRS audit cost).

Chapter 28: Depreciation

Page 738

The OBBBA allows domestic research and experimental expenditures to be fully deducted in the year when paid or incurred with an election to amortize them over not less than 60 months. *See* § 174A.

Page 778-82

The OBBBA provides that the maximum amount a taxpayer can expense under § 179 for taxable years beginning after 2024 is increased from $1M to $2.5M, reduced by eligible property placed in service during the year in excess of $4M. These amounts are inflation adjusted after 2025. Thus, at $6.5M of eligible property placed in service in 2025, taxpayers will not be eligible for any § 179 deduction.

The maximum amount of § 179 deduction allowable for a sport utility vehicle in 2025, as indexed for inflation, is $31.3K. *See Rev. Proc. 2024-40*, 2024-45 I.R.B. 1100.

The OBBBA provides that 100% of the cost (after reduction by any § 179 write-offs) of eligible property acquired after January 19, 2025, is deductible under § 168(k) for the taxable year in which the property is placed in service. This essentially makes the § 168(k) 100% bonus depreciation/expensing for most types of depreciable tangible personal property a "permanent" fixture of the federal income tax system.

The OBBBA also enacted a new § 168(n) that also provides a 100% expense deduction for the cost of qualified production property the construction of which starts after January 19, 2025, and before 2029 and which is placed in service in the United States or a U.S. possession (e.g., Puerto Rico and the Virgin Islands) after July 4, 2025, and before 2031. This is a defined class of depreciable business nonresidential real property (i.e., the depreciable building but not the underlying nondepreciable land) used in the manufacturing, production, or refining of a "qualified product," which is generally any tangible personal property other than food or beverages prepared and sold in the same building. "Qualified production property" for this purpose does not include the portion of real property that is used for offices, administrative services, lodging, parking, sales activities, research activities, software development or engineering activities, or other functions that are unrelated to manufacturing, producing, or refining tangible personal property. This limitation could raise some challenging allocation issues for determining what portion of the cost of a depreciable building qualifies for this deduction.