Acc 333 Outline, Federal Taxation June 2020 © Richard Malamud

Updated as of 6/12/2020)
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Not everything is up to date – but changes due to HR1, the new tax act are in Red and are different then in your textbook if you have an edition before 2021

Individual Taxation:

1. **Chapter 1**
   a. Law made possible by the Sixteenth Amendment to the Constitution
   b. Original tax rates 1% to 7%
   c. Law now known as the Internal Revenue Code of 1986, as amended
      i. Substantial changes for 2018 and beyond by HR1 - 12/22/17
   d. Tax law enactment. The bill must start in the House of Representatives, then go through the ordinary law structure, passage by both houses and signature by the President.
   e. The IRS is a part of the Department of the Treasury
   f. Statute of Limitations
      i. Generally 3 years from the later of the due date of the return (April 15, is filed before that date) or the filing date
      ii. 6 years if more than 25% of gross income is not reported
      iii. Unlimited if a fraudulent return is filed
   g. Interest
      i. Is payable by the IRS if a refund is not paid within 45 days of filing the return.
      ii. Is payable by the taxpayer if an amount is not timely paid
   h. Penalties (plus interest)
      i. Failure to File on time = 5% per month (or fraction thereof) up to 25%
      ii. Failure to pay on time = 0.5% per month (or fraction thereof) up to 25%
         1. Maximum of 25% combined under the two penalties for first 5 months, then .5% per month until 50%
         2. Penalty is based on net tax due (Tax - payment)
      iii. Negligence = 5% (such as failure to report income)
      iv. Fraud = 75%

Research, (Chapter C-1 in the middle of the book)

   i. Method of communicating research, "IRAC"
      1. Facts
      2. (**I**) Issue
      3. (**R**) Rule
      4. (**A**) Analysis
      5. (**C**) Conclusion
   j. Source of the tax law
      i. The law - Internal Revenue Code of 1986, as amended –
         1. Law is listed by number,
            a. For example, income is Section 61(a)(1)(B)
      ii. Treasury Regulations - IRS written (codified explanations of the Code) by number, Reg. Section 1.61-1
         1. Legislative (when Congress has requested specific guidelines) has the force of law
         2. Interpretive (under the IRS general authority) hard to beat by taxpayer as this is well thought out, reviewed and opinions solicited
         3. May be proposed, temporary or final
      iii. Other Treasury interpretations:
         1. Revenue Rulings (specific facts generally written just like a memo in IRAC format, but not always), numbered by year and number, Rev. Rul. 99-3
         2. Revenue Procedures (procedures for filing, such as how to mail in a return). Rev. Proc. 99-3.
         3. Letter rulings - requested by taxpayers and issued by the IRS, are

binding on the IRS for this taxpayer only.

iv. Available courts if taxpayer and IRS can't agree
   1. Tax Court (1 court in D.C. that travels)
      a. Must file within 90 of IRS letter
      b. Don't have to pay the tax!
   2. District Court - Judge and Jury, must pay the tax
   3. U.S. Court of Federal Claims - Judge only

v. Tax Treaties, between U.S. and foreign countries

vi. Lots of Tax Magazines

vii. Treatises, books on specific tax subjects

viii. Tax Services
   1. Complete list of the law, code, regs, rulings, cases, etc, either by code section or subject
   2. RIA Federal Tax Coordinator in our Library
   3. CCH Standard Federal Tax Reporter
   4. Mertens

2. **Chapter 2 - Determination of the Tax**

a. Tax Formula for individual taxation:
   i. All income
   ii. - Exclusion = Gross Income
   iii. - Deductions for adjusted gross income ("AGI") = AGI
   iv. - Greater of
      1. Standard deduction, or
      2. Itemized deduction
   v. - Personal & dependency exemptions =
   vi. Taxable income
   vii. Times tax rate based on filing status = tax
   viii. + additional taxes, - credits = net due

b. Tax Rates 2020

Rate for taxable income over	For Single Individuals	Married Individuals Filing Joint Returns	For Heads of Households
10%	$0	$0	$0
12%	$9,875	$19,750	$14,100
22%	$40,125	$80,250	$53,700
24%	$85,525	$171,050	$85,500
32%	$163,300	$326,600	$163,300
35%	$207,350	$414,700	$207,350
37%	$518,400	$622,050	$518,400

Capital gains at lower rates (long term only 1 plus years)

FILING STATUS 2020	0% RATE	15% RATE	20% RATE
Single	Up to $40,000	$40,001 – $441,450	Over $441,450
Married filing jointly	Up to $80,000	$80,001 – $496,600	Over $496,600
Married filing separately	Up to $40,000	$40,001 – $248,300	Over $248,300
Head of household	Up to $53,600	$53,601 – $469,050	Over $469,050

c. Exemptions for 2020 is $4,300 but it is only used to determine adult dependents, there is no longer a tax deduction for Exemptions

d. Standard deduction
   i. An allowance (deduction) based on filing status, age and eye sight of the taxpayer only (not their dependents)
   ii. Amounts:

Filing Status	**Deduction Amount**
Single	$12,400
Married Filing Jointly	$24,800
Head of Household	$18,650
Married Filing Separately	$12,400 (but only if spouse doesn't itemize

      1. Additional amounts for blind or 65 or older:

	2020
Unmarried	$1,650
Married	$1,300

e. Note: **The age additional amounts for 65 and older and blind are now both used for both filing requirements (previously only 65 was used for filing).**
   i. Blind – sight worse then 20/200 or 20 degrees of viewing.
   ii. 65 on which date, 12/31 or 1/1/ of the next year?

f. **Also note that if you itemize, this extra is irrelevant.**

See the Syllabus or end of the outline for the chart!

   i. Exceptions:
      1. Married filing separately must itemize if his or her spouse itemizes, if not, then same as single.
      2. Dependents –
         a. 2020 Greater of:
            i. Earned income + 350, or
            ii. $1,100
         b. Not more then the standard deduction, $12,400
   ii. Phases out for high income taxpayers 2018 –
      1.

g. Personal & dependent exemptions are now CREDITS. So, no deduction as there was in prior years of $4,300 in 2020 – all that's left are credits
   i. Qualifying Child = $2,000 credit ($1,400 refundable)
   ii. All other dependents = $500 credit
   iii. Amount per year
      1. 2020 = would have been $4,300
      2. But no longer a deduction
   iv. It used to phases out for high income taxpayers
   v. You used to be able to claim one each for you and one for a spouse (only if you file a joint return since your spouse can not be your dependent – weird?), unless you are a dependent –

h. Definition of dependent depend, either:
    1. Qualified Child or
    2. Qualified Relative
  ii. Qualified Child - uniform definition
    1. Child of taxpayer, sibling and descendants of either (adopted or foster or step)
    2. Under 19, or full time student under 24, or permanently or totally disabled -

Note, if the child is over 23 then they must qualify as another dependent - a 24 year old can't be a "qualified child"

    3. Must have the same abode (house) as the taxpayer for at least half the year
    4. Support - the child can not provide more than one-half of his or her own support.

It is not required that the taxpayer provide the support

i. Must be younger then the taxpayer
j. Tie Breaking Rules (if more than one person claims the dependent - if not it goes to the qualifying one who does claim the dependent)
    1. Qualifying Child beats out other dependent
    2. Parents have priority over others
    3. If the two above don't resolve it, then the taxpayer with the highest AGI gets the exemption
  ii. Qualified Relative (Other dependent) 5 parts (all must be met)
    1. Support - you must provide over half the support for the dependent
      a. Exception: Multiple Support Agreement
        i. Would qualify under the other test, but gave < 50% and > 10%
        ii. All such qualified persons must sign Form 2120 to allocate the personal exemption among them.
        iii. If anyone give over 50%, not multiple support, they get the exemption
      b. Exception: Divorce
        i. Exemption goes to the parent with custody (majority of the time)
        ii. Can be given to non-custodial parent by signed agreement, Form 8332
    2. Gross Income - Dependent's gross income (from taxable sources must be less than the exemption amount (2020 = $4,300) (Has nothing to do with net assets or support!)
    3. Relationship or residence
      a. Relationship as listed (doesn't include cousins), or
      b. Lives with the taxpayer the entire year (and not an illegal relationship)
  iii. For all dependents
    1. Dependent can not file a joint return
    2. Citizenship of U.S. or resident of U.S., Mexico or Canada (even illegal)
    3. Has a social security or ID number by the time the return is filed

k. Child tax credit for Qualifying Child 2020 =
  i. $2,000 credit per child for Qualified Child under 17, $1,400 refundable
  ii. Other dependents
    1. $500 credit
  iii. Phase out for high income taxpayers
    1. $200,000 - $240,000 Single, MFS, HH
    2. $400,000 - $440,000 MFJ

l. **Filing status**
  i. Joint return can be filed if married - If legally married on the last day of the year (or at the time of death if during the year and not remarried that year)
    1. Both responsible for 100% of the tax shown

            2. Exceptions for innocent spouse
        ii. Married couple can file separately
            1. Each year can be determined without regard to the prior or next year
        iii. Surviving Spouse:
            1. For the two years following the death of a spouse
            2. Must have been able to file joint return in year of death
            3. Must have 1 dependent **Child** living at home
        iv. Single - if not married
        v. Head of Household
            1. Single on the last day of the year, unless spouse died during the year (or abandoned spouse)
            2. Not a surviving spouse
            3. US citizen or resident
        vi. Pay over one half the cost of maintaining your home, in which a dependent relative lives more than half the year. Exception for your parent that you support doesn't have to live with you
            1. Exception for divorce - custodial can claim head of household even if the dependency exemption has been passed to the other parent if 50% paid by the one claiming head of household.
        vii. Abandoned Spouse (not a filing status) - the affect is to make a married person singe. As a single person, can therefore qualify as head of household
            1. Live apart from spouse the last 6 months of the year
            2. Pay over half the cost of the house in which the taxpayer and their child lives
            3. US citizen or resident
    m. Special tax rate for dependents under 19 and dependent students under 24, the Kiddie Tax
        i. Who is subject to the kiddie tax?
            1. Your unearned income was more than $2,200.
            2. You meet one of the following age requirements:
                a. You were under age 18 at the end of the tax year,
                b. You were age 18 at the end of the tax year and you didn't have earned income that was more than half of your support, or
                c. You were a full-time student at least age 19 and under age 24 at the end of the tax year and you didn't have earned income that was more than half of your support.
            3. At least one of your parents was alive at the end of the tax year.
            4. You're required to file a tax return for the tax year.
            5. You don't file a joint return for the tax year.
        ii. Their standard deduction is not taxed (minimum $1,100 up to $12,400), then they get earned income at the regular rates
        iii. Unearned income (other than salary) is first taxed at the 10% on $1,100 and then the rest is taxed at the parent’s tax rate
    n. Change of status:
        i. Can change from Separate return to Joint return
        ii. Can not change from Joint to Separate
    o. Who must file (see handout)
        i. Those whose Gross Income exceeds their standard deduction
            1. Plus the additional amount for being over 65,
            2. Plus (new for 2018) additional amount for being blind
        ii. Anyone with net Self-employment income of $400 or more, must file to pay the SE Tax (15.3% of net Self-employment income)
    p. Due date: 15th day of fourth month following the year, April 15th
        i. If Saturday, Sunday or legal Holiday, the next day that isn't.
        ii. Can get an extension to file (must pay by April 15)
    q. Tax Forms:
        i. Page one bottom: AGI or Line (as in above the line)
            1. Now gross income, minus exclusions and above the line deductions (adjustments to income)

ii. Page two; below the line deductions
1. standard or itemized deductions on Schedule A),
2. Personal and dependency exemptions (no longer available)
3. Section 199A deduction (20% of business income)

iii. Self-Employment Tax on Schedule SE
1. 15.3% of self-employment income
   a. 6.2% social security tax (limited to $137,700 2020)
   b. 1.45% Medicare tax (on all self employment income – no limit
2. 3.8% (less 2.9%) = .9% for Obama Care if S.E. > $250,000

Must File for 2020	Standard Deduction	Personal Exemption	Must File	65	Must File	65 & Blind	Must File	
Single	12,400	-	$12,400	1,650	$14,050	$1,650	$15,700	Single
Joint	24,800	0	$24,800	1,300	$26,100	$1,300	$27,400	Joint
Married Separate	See Note 1	0	0	-	$0	$0	$0	Married Sep
Head Household	18,650	0	18,650	1,650	$20,300	1,650	$21,950	Head of Hou
Surviving Spouse	24,800	0	24,800	-	$24,800	-	$24,800	Surviving Sp
Dependent's Std. Dec	See Note 3	Greater of:	$ 1,100	or earned income +		$ 350		
		Maximum of	$ 12,400					
Notes:								
1. MFS the standard deduction is $0 for filing purposes								
2. Additional standard deduction for 65 or blind =								
	Single	$1,650						
	Married	$1,300						
3. Dependent's standard deduction								
	Min. > of:	$ 1,100	or Earned Income +	$ 350				
	Maximum	$ 12,400						

3. **<u>Chapter 3 - Gross Income - Inclusions</u>**
   a. Gross income - Section 61 - "... all income from whatever source derived, including but not limited to..."
   b. Exceptions are generally made by Code provisions
   c. Assignment of income - you must pay tax on your income, no matter who receives the money
   d. Allocating between married persons, in California (Community Property)
      i. Community property rules state that all earnings from services during marriage and all earnings on community property are earned equally by both spouses
      ii. Separate property is that property owned before marriage and earnings from that property and amounts received during marriage as gifts or inheritances
      iii. Applies to filing separate return, each reports 50% of community property and 100% of their separate property
      iv. Also determines how much each gets at divorce or death
   e. Allocating in Separate Property – not covered but basically, each spouse reports their income
   f. When is income taxable
      i. Cash method -
         1. When actually received, or
         2. When constructively received
            a. If the payor is ready, willing and able to pay and the money is

owed, you can't say, "I don't want it, pay me next year" it will be taxable when earned

b. No constructive if not paid do to payor, not payee

3. Except - Series EE savings bond, which is taxed when cashed in or 30 years from issue date

ii. Accrual method -

1. When all the events...
2. Except that generally advanced receipts (prepaid income are taxable when received!

g. Municipal **Bond** Interest is Federal Tax Exempt income if from a State and Local (City or County or some charity) Bonds (indebtedness)

i. Interest on a state tax refund is not on a state obligation so it taxable

ii. It is tax free in California only if it is a California state or local bond

1. Interest on a Nevada bond is taxable to California residents

h. Interest on Federal debt obligations are taxable for federal purposes but are not taxable for state tax returns

i. States can not tax federal bond interest from

1. T Bills – at maturity (1 year)
2. Treasury Bonds and Notes
3. Savings Bonds (Series EE) when cashed in

ii. Interest on federal tax refund is not on a debt so is taxable to federal and state tax returns

i. Dividends – Can be regular or "Qualified" dividend

i. Regular, not based on stock ownership, is taxable the same as any other income (similar to interest)

ii. Qualified dividends from U.S. corporations or stocks traded on major stock exchanges, such as Toyota – which are actual dividends based on stock ownership, are taxed at a maximum tax rate of either **0%, 15%, or 20%.**

1. **Dividends** are distributions from a corporation's current or accumulate earnings and profits (similar to retained earnings)

iii. Qualified divided (and long-term capital gain) tax rate:

FILING STATUS 2020	0% RATE	15% RATE	20% RATE
Single	Up to $40,000	$40,001 – $441,450	Over $441,450
Married filing jointly	Up to $80,000	$80,001 – $496,600	Over $496,600
Married filing separately	Up to $40,000	$40,001 – $248,300	Over $248,300
Head of household	Up to $53,600	$53,601 – $469,050	Over $469,050

1. Plus possible Medicare tax on investment income at 3.8% over $200,000 AGI single $250,000 AGI married filing jointly

iv. Stock dividend is generally not taxable unless there is an option to take cash or property instead of the stock or if the effect is to give only some of the shareholder's their pro-rata share of the stock

v. Capital Gain dividend (generally from a mutual fund, is taxable but receives the favorable capital gain treatment)

vi. Constructive dividend is when a corporation makes an indirect payment, the effect of which is to have paid a dividend

j. Alimony - OLD LAW STILL APPLIES TO EARLIER DIVORCES (known as grandfathered law):

i. Alimony is taxable to the recipient and deducible by the payor. It is defined as alimony only if:

1. It is cash (not property)
2. It is pursuant to a divorce or separation agreement
3. It is not designated as child support or property settlement
4. The couple is living in separate households

ii. Effect of excess front loading of Alimony (recapture)

1. Front loading occurs only in the third year, if the first two years exceeded the prior years by more than $15,000 computed as follows:

            a. Year 1 = Year 1 - (Year 2* + Year 3)/2 - $15,000.
        2. Year 2 = Year 2 - (Year 3) - $15,000
            a. (use the permissible amount from Year 2 in the Year 1 equation, not the amount paid)
        3. The recaptured amounts are deducible by the recipient and taxable to the payor in year 3.

k. **NEW LAW Effective 2019:** for new alimony agreements and modifications after 2018 if the parties agree
    i. No deduction by the person who pays
    ii. No income to the person who receives it
    iii. Thus, if Spouse 1 pays Spouse 2 $4,000 per month, there is no income to Spouse 2 and no deduction for Spouse 1
    iv. Same rules apply to property settlement and child support

l. Pensions are generally taxable in full, unless taxpayer has a basis in the pension, such as a non-deductible IRA account
    i. Basis exists when a contribution is made with after tax dollars which doesn't occur very often, but it is possible

m. Annuities are taxed by a formula to adjust for after tax investment in the annuity:
    i. Expected Return / Investment = Exclusion Ratio
    ii. Expected return uses the IRS life expectancy tables, not family history
    iii. For a 65 year old, it is 20 years
        1. If a $100,000 investment is made for a life annuity, the exclusion is $5,000 per year ($100,000 investment / 20 years)
    iv. Each year's payment is subject to tax, less the excluded part until the investment which is received tax free
        1. If in the above example, the payment is $7,000 a year, $2,000 would be taxable ($7,000 - $5,000)
        2. After fully recovered, 100% is taxable
        3. If you die before 100% recovery of basis (in the example within 20 years) the remaining unrecovered basis is a tax deduction in the year of death
            a. Suppose the 65 year old died at age 80, then the deduction would be $25,000. 5 years left / 20 years total X $100,000 = $25,000
            b. 5/20 = 25% of $100,000 = $25,000

n. Passthrough entities - Estate or Trust, partnerships, S Corporations (individual pays the tax, not the business)
    i. This is covered in Acc. 433
    ii. Income earned by a passthrough business entity taxed to the owner
        1. If a partnership or an S Corporation earned $100,000, a 30% partner must report $30,000
        2. The entity does not pay income tax (except in CA)
    iii. Amounts earned by an estate or trust are different
        1. If an estate or trust earns $100,000, the beneficiary will be taxed on the amount actually received and the trust will pay tax on the rest

o. Section 199A deduction
    i. 20% deduction
        1. of pass-through and direct business and rental net income
        2. or taxable income if lower
    ii. If taxable income is > $315,000 limited phase out to $415,000
        1. Exception - allowed up to 20% based on
            a. 50% of the W-2 wages for the business, or
            b. 25% of the W-2 wages plus 2.5% of the business's unadjusted basis in all qualified property (10 years)
        2. Phase out at $315,000 - $415,000 for any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees [or owners]

p. Prizes, awards, etc. are taxable "income from all sources"

q. Illegal income is taxable - taxed on worldwide income
    i. Plus, that is how criminals are convicted without proving a crime
    ii. Think, Al Capone, Heidi Fleiss, Wesley Snipes, Nicolas Cage, Willie Nelson, Pete Rose and others (only the first two were criminals, not counting the tax evasion, which can be criminal and include jail time.

r. Unemployment income is taxable - make sure to withhold!
    i. Not taxable in CA

s. Social Security Benefits - May be taxable (up to 85%) if "Modified (Provisional) Adjusted Gross Income" is to high
    i. For low income, it is tax free, for limited in the middle 50% taxable and for those making moderate or more income which includes part of the social security it is taxed at 85%; CA doesn't tax social security income
    ii. Married filing separately - 85% is taxable
    iii. Others depends on **MAGI** =
        1. Regular AGI +
        2. Tax Exempt income! +
        3. % (50% or 85%) of Social Security Benefits
    iv. Taxable portion is lesser of:
        1. MAGI - Base Amount, or
        2. (50% or 85%) of Social Security Benefits
    v. Base Amount
        1. Married Filing Separately = 0
        2. Joint = above $32,000 (50%) taxable, above $44,000 (85%)taxable
        3. Single = above $25,000 (50%), above $34,000 (85%)
        4. Very complicate formula, you are **<u>not</u>** expected to be able to calculate it

t. Amounts previously deducted are income if received in a subsequent year, such as taxes, medical expense

u. Claim of right - income when you take the money, even if it isn't yours (theft, finding something)

v. Tax Forms:
    i. Alimony – Page 1 of the return (above the line deduction or income)
    ii. Interest – Schedule B
    iii. Dividends – Schedule B
    iv. Capital Gains – Schedule D

4. **<u>Chapter 4 - Gross income - exclusions</u>**

a. Unrealized income – unsold assets are not taxable income
    i. Must sell assets to realize (calculate gain)

b. Self help (planting your own food) is not income

c. Gifts and inheritances are not income, they are excluded by statute

d. Life insurance proceeds generally are non taxable if paid because of death
    i. Tax free if pre-death "accelerated death benefits"
        1. Accelerated death benefits are usually tax-exempt for individuals expected to die within **two years**
        2. Have doctor's certification of facts
    ii. Taxable if purchased from the owner (instead of from the insurance company), unless purchased by the insured or a partner of the insured. If taxable, taxable on net income (receipts – purchase cost and premiums paid)
    iii. Taxable if cashed in before the death, unless imminent death (see book)
    iv. Dividends on life insurance are generally tax free return of the cost of the policy

e. Awards are tax free, if no additional service required and you don't get the money

f. Scholarships - tax free, up to an amount equal to:
    i. Tuition, books and required supplies
    ii. Thus, taxable if it exceeds that amount such as amounts for room and board

g. Injury and sickness payments (lawsuits) are tax free only if for personal **physical** injury
    i. Emotional distress is taxable (less medical costs)
    ii. **Punitive damages** are always taxable
    iii. Wage replacements are taxable

h. Employer health insurance is tax free to the employee as are reimbursements under a qualified plan (includes amounts of the employee, plus their spouse and children)
i. Self-employed persons may deduct health insurance (not other medical costs) above the line (100% of the insurance for themselves and their spouse and dependents
j. Group term life insurance for employees is tax free up to $50,000 per year
    i. Additional amounts are taxable based on the IRS table
    ii. If $70,000 is received, then the value of the $20,000 is taxable
k. Other employee benefits
    i. No additional cost benefits are tax free, such as standby airline tickets for airline employees, hotel rooms for hotel employees
    ii. Goods and services are tax free if provided to an employee limited to:
        1. For goods, if sold for at least Cost of Goods Sold
        2. For services, up to 20% discount
        3. Additional discounts are taxable - Thus, for $5,000 services, if the employee pays nothing there is $4,000 of income
    iii. Transportation reimbursed by the employer –
        1. Previously, tax free for parking or rail pass up to $260 a month
        2. Now, taxable unless the employer elects to not deduct the cost
    iv. De minimis - small stuff like coffee, photocopies, etc
    v. Employee achievement or length of service is tax free if property (not cash!) and for achievement or at least 5 years of service
    vi. Employee death benefits are taxable (unless a gift-rare!)
    vii. Dependent care is a tax free benefit, but there are limits
    viii. Educational assistance - up to $5,250
    ix. Cafeteria Plan (pick what you want out of your own money that you leave with the employer) generally used to pay deductible medical bills, braces, psychiatrists, etc
l. Foreign **earned** income - Exclusion up to $107,600 (2020)
    i. Must be foreign resident entire year, or
    ii. 330 days during the 12 month period
m. Income from discharge of indebtedness is taxable, unless you are
    i. insolvent at the time or
    ii. bankrupt
n. Exclusion for small business stock
    i. 50% excluded
    ii. Post August 10, 1993 stock held 5 years
    iii. $10,000,000 maximum
    iv. Other 50% taxable at 28%

5. **<u>Chapter 5 Property Transactions - Capital Gains and Losses</u>**
    a. Formula for Realized Gain = Amount Realized - Adjusted Basis
    b. Above = A.R. - A.B. = Realized Gain
    c. Realized gain is "recognized" (reported on the tax return) unless there is a specific non-recognition provision
    d. Amount Realized = Cash plus FMV of other property received
    e. Adjusted Basis = Initial Basis (usually cost) + increases (improvements) - decreases (depreciation or deductions)
    f. Losses can be recognized if:
        i. Trade or business
        ii. Activity entered into for profit
        iii. Casualty or theft loss only if Presidentially declared disaster
            1. California has not conformed to this rule
        iv. Personal losses (sale of home or car) are not deducible
    g. Basis = Cost - purchase price (not cash paid, thus notes and mortgages are taken into account)
    h. Interest and real estate taxes on production of the asset must be capitalized if real estate or over two year production cycle
    i. Gifts = Basis = it depends on the value at the time the gift is made
        i. Generally, a carryover basis (the donor’s cost) unless the value of the property is less than cost at the time of the gift

1. Thus, for sales at a gain = Donors basis (carryover basis)
2. For sales at a loss when at date of gift, FMV < Cost as you can't pass a loss as part of a gift:
    a. Lesser of:
        i. FMV date of gift (if less than cost) or
        ii. Donor's Cost if less than fair market value at time of gift
3. Ex. FMV $10,000, cost $6,000, then $6,000 is always the basis

ii. If both of the above don't apply, no gain or loss
1. Ex. FMV $ 6,000, cost $10,000, then for loss the basis is $6,000, for gain the basis is $10,000 and in between, no gain and no loss

j. Adding Gift Tax to the appreciated gifts when the gift is subject to tax
- i. Add Gift tax x (FMV - Basis)/FMV.
- ii. Effect is to add the gift tax on the appreciation only (currently 40%)

k. Inheritances
- i. Basis is generally FMV date of death, or
- ii. FMV @ Alternative Valuation Date (6 months later)
    1. Must be elected on all assets
    2. Total value must be less than at the Date of Death
    3. Estate tax must be lower which requires an estate of over $11,500,000
- iii. Community Property - basis is "stepped up" to FMV on both decedent's and the surviving spouse's property
    1. Ex. A couple owns their house which cost $500,000 and is worth $1,200,000, the decedent's half has a basis of $600,000 and the survivors goes from $250,000 to $600,000 if it was community property
        a. If it was joint tenancy, then the survivors stays at $250,000
- iv. No basis step up if the asset is IRD (income in respect of a decedent)

l. Converted property to business use. For depreciation, use lower of Adjusted Basis or FMV – similar to gifts

m. Capital Asset is defined in the negative as all property **<u>except</u>**:
- i. Inventory
- ii. Property used in business and subject to depreciation
    1. §1245 for personal property
    2. §1250 for real property)
    3. But, under § 1231 rules,
        a. a portion or all the gain will result in long term capital gain if held 1+ years
        b. loss will be ordinary loss
        c. All gains or losses from depreciable property are netted each year
- iii. Accounts receivable
- iv. Letters, copyrights, etc. produced by or for the taxpayer

n. Real property subdivided - safe harbor if meet §1237 (not on test)
- i. 5 year hold
- ii. No substantial improvements
- iii. Not a dealer in real estate
- iv. 5 lots are capital gain
- v. On 6th lot and later, 5% is ordinary income

o. Taxation of Capital Gains
- i. Separate
    1. long-term gain or loss (more than one year) from
    2. short-term gain or loss (one year or less)
- ii. Net Capital Gain taxed at 0%,15% or 20%
    1. Net Long Term Capital Gain
    2. Less: Net Short Term Capital Loss
    3. Tax Rates 2020:
        a. 0 % if under $40,000 single and $80,000 joint
        b. 15% up to $441,400 single or $496,600 joint
        c. 20% above that,
            i. Plus Medicare surtax of 3.8% see above

iii. Long Term Collectibles are taxed at 28%
iv. §1231 gains on depreciable property held 1+ years:
1. depreciation recapture on Real Estate taxed at 25%,
2. depreciation recapture on other property taxed at ordinary rates,
3. excess gain at the 0/15/20% long term capital gains rates
v. Capital Losses (net)
1. Deductible up $3,000 per year
2. Remaining amount carries to future years
3. Short term loss used before long term loss

p. Sale or Exchange
i. Sale = all cash
ii. Exchange = some consideration other than cash

q. Worthless securities - treated as sold the last day of the year (Dec. 31)

r. OID - If the bond is originally sold at a discount, then that discount is treated on the accrual basis as income

s. Market Discount Bonds - Discount of more than 1/4% per year is treated as interest income at the time of redemption or sale

t. Options -

u. Patents - §1235 = long term capital gain, if substantially all rights are sold (entire country!) prior law

v. For 2018 - Gains or losses from the sale or exchange of a patent, invention, model or design (whether or not patented), or a secret formula or process which is held either by the taxpayer who created the property or a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created) will not receive capital gain treatment.

w. Lease cancellation payments
i. To lessor = rent
ii. To lessee = capital gain

x. Holding Period to determine length for the 1+ years required for LTCG
i. Gifts
1. If gain basis, then carry-over holding period
2. If loss basis, from the time received
ii. Inheritance = Long Term, regardless of actual time
iii. Non taxable exchanges = carry-over

y. Tax Forms
i. Capital Gains – Schedule D is now a summary only
ii. Details reported Form 8949

6. **Chapter 6 Deductions and losses**

a. Generally either
i. Trade or Business (§162) - above the line, or
ii. Expenses incurred in the production of income or determination of tax (§212)
1. Generally itemized deductions which are no longer allowed for Federal purposes (CA still allows them)
2. Used to be reduced by 2% of AGI
3. However, if it relates to rental property, it is allowed above the line (technically rental is not a trade or business

b. Business Expense (§162) of a trade or business are deductible above the line to get to net income (as is rental but under §212, for both the expense
i. Must be ordinary and necessary
ii. Reasonable in amount
1. Generally applies to payments to related parties
iii. Documented (substantiated) burden of proof is on taxpayer
iv. Incurred by taxpayer but others can pay if they are making a gift or loan
v. Not capitalized
1. Fixed assets vs. repairs
2. Can elect to capitalize some expenses

c. Self-employed are in a trade or business, thus their expenses are above the line

d. Legal fees may or may not be deductible; it is based on the underlying expense. Thus, legal fees of a business are §162 expenses, legal fees to fight the IRS are

§212 itemized deductions and legal fees to sue your neighbor or get a divorce are non-deductible personal expenses

e. Expenses related to tax exempt income are not deductible
   i. But for test in most cases
   ii. Exception for home purchase or long-term business loans
f. Expenditures contrary to public policy are not deductible
   i. Illegal payments
   ii. Fines and penalties such as a traffic ticket by an Uber driver
   iii. But, expenses of an illegal business are deductible (unless it is the drug business - §280E)
g. Business investigation -
   i. Not deductible, must be capitalized
   ii. Amortized over 15 years (180 months) from the start of the business
   iii. If you investigate but don't start the business, no deduction
   iv. Once in business, investigating an extension of the business is not capitalized, it is an expense
h. Substantiation
   i. Generally taxpayer burden of proof, but see Cohan rule
   ii. Specific, must have documentation rule for
      1. Travel and entertainment
      2. Business meals
      3. Computers and automobiles
i. When is it deductible?
   i. Cash basis, when paid
      1. Prepaid must be amortized if substantially beyond the year
      2. Prepaid interest must be amortized
      3. Payment by credit card is when "payment" occurs
   ii. Accrued (when all the events test is met)
      1. Economic Performance Test:
         a. When services are provided
         b. When products used
         c. Exception allows current accrual for "recurring items" if elected
j. Wash sales (losses only) are not deductible
   i. Sale at a loss, and within 30 days before or after
   ii. Substantially identical stock is acquired
k. Related Party Rules (§267) loss and expenses not allowed
   i. Disallows losses on sales of property to related parties (basis carries over) but gains to the same parties are taxable
   ii. Disallows expenses <u>accrued</u> to related cash basis parties until the related party reports the income (**deductible when paid**)
      1. Salary
      2. Interest
      3. Rent
   iii. Related parties
      1. Individuals and spouse, siblings, ancestors (up or down)
      2. Related trusts, partnerships and corporations (generally with greater than 50% ownership
      3. But sales of property to spouses during marriage or incident to divorce are never taxable – treated as mutual gifts
l. Hobby Losses
   i. Not a trade or business, thus "hobby" (facts and circumstances)
      1. If profit in three of last five years, burden shift to IRS to prove hobby
      2. Otherwise, taxpayer must prove it is a business
   ii. Effect is that gross income is reported and no deductions because of Section 212 (except in CA) bad rule!
m. Vacation home - when a home is used for both personal and rental
   i. Home if used as a home the greater of:
      1. 14 days (days doing repairs not counted), or

        2. 10% of the days rented
    ii. Rental unless rented less than 15 days
    iii. Allocation of expense deduction if both
        1. Total Expense X (# days rented)/(# days rented + # days pers. use)
        2. Rental days only include actual, not days "for rent"
    iv. No loss is allowed, expenses are limited to gross income (except that taxes and interest may be allowed)
n. Office in the home
    i. Must be a principal place of business, or meeting with clients
    ii. Benefit, you can write off some of your home's costs
o. Tax Forms
    i. Section 162 trade or business Schedule C (business) or Schedule F (farm), or Schedule E (rental)
    ii. Employee Business Expense, Schedule A itemized
    iii. Self-employed – Schedule C
    iv. Hobby loss, income on page 1, deductions on Schedule A

7. **<u>Chapter 7 Losses and Bad Debts</u>**
    a. Many different causes of losses
    b. Deduction depends on type of property
        i. Allowed on trade or business
        ii. Allowed on investment property
        iii. Not allowed on losses from personal (non-investment) property, such as homes, cars etc. but gains on the same property are taxable, e.g. your home
    c. Worthless securities
        i. In the year it becomes worthless
        ii. Treated as if it occurred on the last day of the year
    d. Must determine whether ordinary or capital (see Chapter 5)
    e. Section 1244 stock sale allows capital loss to be ordinary loss
        i. Up to $50,000 ($100,000 joint return) if
            1. Stock owned by individual
            2. Originally issued by the company
        ii. Less than $1,000,000 of stock was issued at the time of acquistion
    f. Passive Losses – may disallow current loss
        i. Limits losses from passive activities
            1. Can offset other passive income
            2. Losses from publicly traded partnerships can’t be offset by any other proeprty
        ii. Allows suspended losses to be used in future years against future income
        iii. Allows suspended losses to be used in the year of disposition
        iv. Definition:
            1. Trade or business in which taxpayer does not materially participate, or
            2. Rental property (business)
            3. If a trade or business it is passive unless there is Material participation by the owner which is any of the following:
                a. 500 hours per year of work
                b. All the activity for the business
                c. Worded 500 hours 5 of last 10 years
                d. Facts and circumstances
            4. Rental property (more than 30 days) is always passive
            5. Real estate rental is not a passive activity if someone is a real estate professionals, if
                a. Majority job is real estate business and
                b. 750 hours in real estate job
        v. For some passive rental, up to $25,000 passive loss is allowed on rental real estate losses if
            1. If AGI <$100,000, phases out at $150,000
                a. Phases out $1.00 of loss for $2.00 of AGI
            2. Must be active participant and 10% owner
                a. Not much activity required, just review the leases or the budget

g. Casualty Loss for 2018 and later only if Presidentially declared disaster (but all still allowed in CA)
   i. Identifiable event
   ii. Sudden or unexpected
   iii. Casualty (fire, storm, shipwreck, flood, earthquake, etc.) or theft
   iv. Limited on personal loss
      1. Yearly total must exceed 10% of AGI
      2. $100 reduction for each event
      3. Reduced by insurance reimbursement (claimed or claimable)

h. Bad Debts
   i. Must use specific write off method even if accrual accounting used
   ii. Must be bona-fide (family losses or friends depends)
   iii. Limited to basis (accounts receivable on cash basis = no loss!)
   iv. Must be totally worthless
   v. Business equals an ordinary expense (deduction)
   vi. Nonbusiness - non trade or business debts
      1. Treated as Short Term Capital Losses
      2. Length of time is not relevant
   vii. Subsequent recoveries are income in the year recovered

i. Net Operating Losses
   i. Business or personal
      1. Generally when you have business losses greater than income or a casualty loss greater than income
      2. Usually when AGI is negative for personal
   ii. Carried back 5 year (Corona change to the law) - can elect to waive carryback
   iii. Carried forward until used or death

8. **Chapter 8 Itemized Deductions (Schedule A, Form 1040)**

a. Medical Expense
   i. Who qualifies?
      1. Taxpayer and spouse
      2. Dependent (but need not meet the gross income test)
      3. Children of divorce (if one of the parent's can claim) whoever pays the bills gets the deduction
      4. Also, persons who would be a dependent but the person earns more than $4,300 (for example an adult child who you pay over ½ their support, they qualify even though not a dependent
   ii. What qualifies?
      1. Medical, dental, eye insurance and Medicare insurance
      2. Doctors, dentist, chiropractors, phycologists, eye exams, etc.
      3. Glasses, braces, wheelchairs, etc.
      4. Prescription drugs and insulin (not over the counter)
      5. Transportation for medical
         a. 17 cents per mile for 2020
      6. Lodging @ $50 per night maximum – no meals
      7. Capital Expenditures (to the extent they don't increase FMV of property)
      8. Medical Insurance – medical, eyes and dental
      9. Self-employed health insurance = 100% above the line)
      10. But not COSTMETIC surgery unless to cure or fix a defect
   iii. When paid! (credit card = payment)
   iv. Limitation - Must exceed 7.5% 2020

b. Taxes
   i. Deductible limited to a maximum of $10,000 MFJ or single for all deductible taxes
      1. Income:
         a. State and local income taxes (California income taxes, withholding, estimated payments)
         b. **<u>or</u>** Sales Tax for people in Texas or Nevada etc. with no income tax
      2. Personal property tax (your car's registration)
      3. Real Estate property tax

            4. State local and even foreign real property taxes
      ii. Taxes paid in a trade or business (except Calif. income tax) are generally deductible as expenses or capitalized into the inventory/project
      iii. Social Security Tax – the employer tax 1/2 (gets an above the line deduction)
      iv. Not Deductible
            1. Federal income taxes
            2. Inheritance and gift taxes (gift taxes may be added, in part, to basis)
            3. Social Security Taxes (employee's 1/2)
      v. When deductible? When paid, not when due!
            1. Ex. When you filed your 2019 CA income tax return in 2020, and paid an amount due of $600, it is deductible in 2020, not 2019
   c. Interest - Must fall into a deductible category:
      i. Active trade or business - deductible against the business income
      ii. Passive Activity - deductible against the passive activity to get to net income
            1. Definition of passive activity - A trade or business in which the taxpayer does not materially participate, or any rental business,
                  a. Up to $25,000 of losses allowed if the taxpayer "actively" engages in the rental business if AGI < $100,000
                  b. If a real estate professional = 750 hours and it is the majority job, then not a passive activity and can take all the losses
      iii. Investment interest - interest on debts to purchase investments such as
            1. Stocks or bonds
            2. Deduction is limited to net investment income
                  a. Gross income from stocks, bonds, bank interest, etc. plus short term capital gains from the sale of such items
                  b. Less: Investment expenses (itemized deductions related thereto)
                  c. Ex. You borrowed money to buy stock and paid $15,000 of interest. Your total dividend and interest income is $13,400, your (itemized) deduction for interest is $13,400 with a $1,600 carry over to next year
      iv. Qualified Residential pre 2018
            1. Loan must be secured by the residence!
            2. Loan is used either to buy the property (acquisition) or construction or improve the house,
                  a. Limited to loan total of $1,000,000 (post Oct. 13, 1987), grandfathered for pre 2018 loans and
            3. CA still allows interest on up to $100,000 of home equity loan, but not federal
            4. Can only be on the principal residence and any one other residence
            5. Refinanced loans keep their original character, but, the amount can not be increased, unless used to improve the home
            6. Points – 1% of the loan used to buy down the interest rate
                  a. Only deductible if purchase of principal residence
                  b. refinanced loans or other loans must be amortized over the life of the loan
            7. 2018 – Same rules but the limit to new loans (purchases after 2017) is loans up to $750,000 for Qualified Acquistion, to Build or to Rehab
                  a. No Home Equity of $100,000 (unless used to build or rehab)
      v. Student Loan
            1. Above the line! if
            2. Up to $2,500
            3. Phased out for AGI > $50,000 ($100,000 joint)
            4. Only for higher education loans
            5. Can't qualify if a dependent!
      vi. Other - not deductible!
   d. Charitable Contributions
      i. Various organizations qualify, the IRS publishes a list!
      ii. Value

1. Cash = $
2. Property
    a. Ordinary income property = lower of basis or FMV
        i. Ex. Used car that cost $30,000 but is woth $3,000, = $3,000
    b. Unrelated use of tangible personal property = lower of basis or FMV unless given to
        i. a charity that uses it in its exempt function such as appreciated art to a museum
    c. Real estate, intangibles (like stock) and related use property = FMV if sale would be long-term capital gain.
        i. No deduction is allowed for any short term capital gain (basis only)
3. Services -
    a. only out of pocket costs and
    b. mileage 14 cents per mile (all years)
4. Limitation
    a. 60% of AGI for cash and basis
    b. 30% of AGIfor appreciated property
    c. Total of all can not exceed 60%
5. Excess amounts carry over for 5 years only and current years amounts are used first!

e. Miscellaneous Itemized Deductions - Section 212(must exceed 2% of AGI) No longer deducible for Federal 2018 (but still allowed for California)
    i. What items?
        1. Employee business expenses
            a. Union dues
            b. Clothing only for business
            c. Continuing education
        2. Expense to produce income (not trade or business)
            a. Legal fees
            b. Clean up
        3. Tax advice
            a. Annual accounting
            b. IRS Audits
            c. Tax planning

9. **Chapter 9 Employee Expense**

a. Employee vs. Independent Contractor (Business)
    i. Employee expenses are misc. itemized deductions - Less 2% of AGI and no longer deductible
        1. But reimbursement by the employer is tax free!
    ii. Business expenses are above the line
    iii. So, important to determine if you are an employee or an independent contractor
        1. What are Uber drivers? Currently independent, but CA is trying to get them classified as Employees, in which case, they can't take deductions for their expenses (except on their CA returns)

b. Misc. itemized deduction subject to 2% reduction, eliminated 2018
    i. Unreimbursed employee business expenses
        1. Job hunting
        2. Union dues
        3. Education
        4. Special clothing
        5. Employee business expense
    ii. Investment expenses
        1. Wall Street Journal
        2. Seminars (but no travel out of town)
    iii. Tax return preparation and related expenses
        1. Planning
        2. Preparation

3. IRS and Court costs

c. Travel
   i. Defined as away from home overnight
   ii. Connected with business
   iii. For airfare - primary purpose must be business
   iv. For Hotels, meals prorate days that are business/personal
   v. If trip is only for general education - not deductible
d. Transportation (and travel) includes
   i. Taxis, Tolls, Parking
   ii. Getting to a second job in one day
   iii. To a temporary job
e. Temporary job?
   i. Less than one year
   ii. Facts are as originally understood
f. Auto is either actual or cents per business miles
   i. 2020 – 57.5 cents per mile
g. Meals (and Entertainment)
   i. Entertainment no longer deductible for federal
   ii. Meals are deductible, but then limited to 50%!
   iii. Directly Related meals are allowed,
      1. business discussions, not just goodwill
      2. Indirect allowed if immediately precedes or follows a business meeting
      3. If on travel status (away from home overnight) then meals qualify as business meals don't need any business discussion
   iv. Club dues and tickets to events are no longer deductible
h. Business Gifts - Limited to $25 per year per donee
i. Employee reimbursement
   i. If an accountability plan, no income to employee
   ii. If not, income to employee and itemized deduction for costs
j. Moving expenses no longer deductible in 2018 but still in CA
   i. Allowable as an above the line deduction
   ii. Only direct costs allowed
      1. Cost of moving your things (Van costs)
      2. Cost of travel to new job (hotel but no meals)
   iii. New job must be at least 50 miles further from your old home than was you former job from your old home
   iv. Must stay at the new job at least 39 weeks in the next 12 months
   v. For self-employed 78 weeks in next two years
   vi. Students starting their first job can qualify
k. Education expenses - only if Self Employed
   i. Allowed:
      1. Allowed if to maintain or improve skill of existing job
      2. Or to meet new requirements of the job
   ii. Not allowed, even if the above is met:
      1. Not deductible if they are to meet the minimum requirement of the job
      2. Or prepares for a new trade or business
l. Office in home - only if Self Employed
   i. Must be exclusively used as office
   ii. Must be principal place of business or meet clients, or
   iii. Used for administrative purposes and no other place to do it
   iv. Expenses related to the house are limited to those otherwise deductible, plus the income from the business
m. Tax Forms
   i. Moving Expense Form 3903
   ii. Home Office Form 8829

10. **<u>Chapter 10 MACRS Depreciation and Cost Recovery</u>**

a. For currently acquisitions, use MACRS (Modified Accelerated Cost Recovery System)
b. For business property and assets held for the production of income
c. When calculating gain, must reduce basis of asset by depreciation allowed or

allowable

d. Depreciation begins when a property is placed in service (not purchase date)
e. Types of property
    i. Personal Property
        1. Tangible
        2. Intangible
    ii. Real Property
        1. Residential
        2. Other (commercial)
f. If property is converted from personal to business, basis is lower of:
    i. Cost
    ii. FMV
g. ACRS - used 1986 and before - most personal property was 5 year property
h. MACRS - current system for new or used property
    i. Personal property convention
        1. 1/2 year in year of purchase or sale
        2. DDB (double declining balance - switch to straight line)
        3. Classification:
            a. 5 year - cars, trucks and computers (fax, etc)
            b. 7 year - other tangible property (a few exceptions)
    ii. Real Estate
        1. 1/2 month in month of acquisition
        2. Straight line
        3. Classification
            a. Residential - 27.5 years
            b. Non-residential - 39 years
    iii. IRS Tables provided
        1. Use cost times the percentages indicated for each year
        2. In year of sale use 1/2 the amount in the chart (the chart is for a full year)
        3. Real estate tables are in the book's appendix, C7 and C9
i. Bonus depreciation = 100% of tangible personal property
    i. So, if business buys $60,000 of personal property it can take $60,000 of bonus depreciation
    ii. CA does not allow this
j. Expense rather than depreciation - §179 (Can use for CA or Federal)
    i. Amount = $1,040,000
    ii. Phase out if tangible property purchased during the year exceeds $2,590,000
    iii. Only applies to tangible personal property used in a business and not for rental property
    iv. Must be reduced $ for $ for tangible personal property acquisitions during the year of more than $2,590,000
    v. Can not use §179 expense to produce or increase a loss for the year
    vi. If loss, excess carries over to future years
k. Listed property - Cars, computers, cell phones
    i. To use MACRS business use must exceed 50%
    ii. Must be for the convenience of the employer for EE bus. expense
    iii. If less than 50%, must use straight line method
    iv. Luxury automobiles
        1. Calculated under MACRS if > 50%
        2. Maximum in years 1 - 5 are set to luxury car amounts
l. Depletion allowed on mineral interests
    i. Percentage depletion (15% of revenue) allowed for small producers
    ii. Cost depletion for the big companies
m. Section 197 - Goodwill
    i. Allowed for post Aug. 13, 1993 acquisitions
    ii. Goodwill is extensive, it includes goodwill, customer lists, turn-key covenants, etc.
    iii. Method of write off, straight line, 15 years

n. Research and Experimentation (R&D)
   i. Can either capitalize and depreciate, or
   ii. Expense
   iii. Credit may also be available
o. Exceptions
   i. Method not expressed in terms of years, such as units of production
   ii. Income forecast method
p. Other issues - land is not depreciable
q. Tax Form for depreciation Form 4562

11. <u>Chapter 11 Accounting Periods and Methods</u>

a. Installment sales
   i. Treat deferred sales as current sale
   ii. Report only the % of the profits based on the percentage of the receipts received
b. Imputed Interest
   i. These rules were designed to tax loans with no or low interest payments
   ii. Can apply to purchases and sales
   iii. Can apply to family/business loans
   iv. Must charge at least 100% of the applicable federal rate (AFR) to avoid rules
c. Family loan - gift loans
   i. If no interest charged, each year a fiction is created in which
      1. Interest is treated as paid
      2. An additional gift is made equal to the interest paid
d. Assuming a $1,000,000 loan and an 8% AFR:
e. <u>Parent Child</u>

Interest expense $80,000 child
Interest income $80,000 parent
Gift $80,000 parent
Gift $80,000 child (not taxable)

In the business context:

<u>Employer Employee</u>
Interest expense$80,000 employee(maybe)
Interest income $80,000 employer
Salary expense $80,000 employer
Salary income $80,000 employee

12. <u>Chapter 12 Property Transactions - Non taxable exchanges</u>

a. Like Kind Exchanges
   i. Tax free exchange for trade or business or investment property
   ii. Must be like-kind
   iii. 2018 limited to Real Estate
      1. personal property inside the real estate does not qualify
   iv. U.S. real estate must be exchanged for U.S. real estate
   v. Must be same class
      1. Any real estate for other real estate
         a. apartment for office
         b. house for land
   vi. Direct exchange must occur
   vii. Exception - Third Party exchanges know as Like Kind Exchange or Section 1031 Exchange
   viii. Exception - Non simultaneous exchange
      1. New property must be identified within 45 days of sale
      2. Must be acquired within the early of:
         a. Due date of the return (plus extensions), or
         b. 180 days of sale
   ix. Receipt of boot is taxable up to the amount of gain or boot, whichever is less
      1. Boot is any cash, or

        2. Any non like-kind property
   x. Basis of new property
        1. + Basis of the old property,
        2. - Boot received,
        3. + Gain recognized
   xi. Related party exchanges are not qualified if the property is disposed of within two (2) years
   xii. Holding period
        1. Exchanged property includes holding period of the old property
        2. Boot begins on the date of the exchange
b. Involuntary Conversions
   i. Allows an election to defer gain on involuntary conversion
   ii. Can receive cash or boot as long as it is reinvested
   iii. Threat is sufficient (if real)
   iv. Must be involuntary, but negligence is ok
   v. Gain realized (amount received - adjusted basis) but is not recognized if
        1. Purchases replacement property
        2. Cost of replacement property is = or greater than the amount realized
        3. If replacement is less than the amount realized, the difference is boot
            a. Gain is the lesser of boot, or
            b. Realized gain
   vi. Basis of replacement property
        1. + Cost of the new property
        2. - Deferred gain (un-recognized gain)
   vii. Severance damages
        1. Represents payments for a small piece of land taken
        2. Reduced basis of the remaining land
   viii. Non recognition is mandatory if there is a direct conversion into replacement property
   ix. Replacement property must qualify
        1. Functional Test -
            a. More restrictive than like kind exchange
            b. Must function in the same way
            c. If real property used in trade or business - like kind test
        2. Taxpayer use test
            a. For rental property - must therefore acquire rental property
            b. Function of the lease may be different
   x. Obtaining replacement property
        1. Must be purchased
        2. Must be within the next two taxable years
        3. For real property - next three taxable years
        4. Time period can be waived by the IRS
c. Sale of Principal Residence
   i. After May 7, 1997, may exclude gain on sale
        1. $250,000 if single
        2. $500,000 if married
   ii. Must have owned and lived in the property 2 of the last 5 years (only one spouse has to own)
   iii. Loss is not deductible
   iv. Must be the principal residence
   v. Principal residence includes, condo, boat, etc.
   vi. Can only be used every two years
        1. Unless change of employment or
        2. Change of health
   vii. Ownership and use test
        1. Must own and use for 24 months of the last five years or sold in less than 24 months from the prior sale
            a. Shorter ownership and use will be pro-rated if unforeseen circumstance

b. such as losing job, having twins, transferred job to a new city, etc.

viii. Involuntary conversion of principal residence
1. Can elect deferral
2. Can instead use the exclusion
3. If Presidentially declared disaster area,
a. Contents not separately schedule do not have to be replaced
b. Time is extended from two years to three

ix. Can elect not to use the exclusion - but why would you?

13. Chapter 13 Property transactions: Section 1231 and recapture

a. Section 1231 gains and losses are netted
i. If net gain, all gains and losses are long-term (gain or loss)
ii. If net loss, all gains and losses are ordinary income or loss
1. Not capital loss
2. Therefore, fully deductible (no $3,000 limit)
iii. If net loss, five year look back
1. For five year, future 1231 gains will be ordinary
2. Up to the 1231 loss claimed
iv. Definition
1. Real Property used in a trade or business
2. Depreciable property used in a trade or business
3. Must be held more than one year (long-term)
v. Section 1231 gain is total gain, less §1245 or §1250 recapture
vi. Section 1231 loss is the loss!

b. Recapture provisions (Sections 1245 and 1250) (See handout on the web)
i. Section 1245 - personal property used in a trade or business
1. Gain is treated as ordinary income to the extent of depreciation recapture
2. Amount is equal to the lower of the gain or the depreciation allowed or allowable
3. Thus, depreciation expense (ordinary deduction) is treated as ordinary income when recaptured
4. Section 179 expense is treated as depreciation for this purpose
ii. Section 1250 - most real estate used in a trade or business
1. Only applies to accelerated depreciation - straight line
2. Since MACRS requires straight line, the is currently no §1250 recapture
3. For corporations 20% of the depreciation recapture potential is treated as ordinary income
iii. Section 1250 tax rate -
1. Unrecaptured gain = what would be depreciation recapture if the property were 1245 property
2. It is treated as 1231 gain, but, subject to a 25% tax rate, rather than the usual 20%
iv. For charitable gifts, ordinary income does not generate a charitable contribution, thus section 1245 recapture does not result in a tax deduction
v. No recapture on gifts, but the potential is passed on with the gift
vi. At death, all recapture disappears, the property takes no a new FMV basis
vii. Installment sales - generally results in gain only being reported as cash (or property)is received
1. Recapture must be recognized in the year of sale
2. Excess gain is reported as payments are received

c. Related party sales
i. If property sold to a related party is depreciable by the buyer,
ii. Gain is treated as ordinary income, not capital gain or 1231 gain
iii. Only applies to sales to majority owned entities

14. Chapter 14 Tax Computations, methods

a. Alternative minimum tax
i. This is an entirely separate tax calculation
1. Pay the difference between the tentative AMT and the regular tax

2. Net result is that regular tax + AMT tax = tentative AMT
    ii. Essentially start with regular taxable income and adjust for
    iii. Tax preferences & adjustments
        1. Depreciation
        2. Tax exempt interest on private activity bonds
        3. Exclusion for sale of small business stock
        4. Incentive stock option
        5. Itemized deductions - only certain ones are allowed
            a. Casualty and theft losses
            b. Charity
            c. Medical (but must exceed 10% of AGI)
            d. Qualified housing interest
            e. Investment interest
            f. Gambling losses
        6. Itemized deductions that are not allowed
            a. Taxes
            b. Miscellaneous itemized deductions
    iv. AMT Exemption 2020
        1. $72,900 for singles and
        2. $113,400 for married filing jointly
    v. AMT Exemption phase out at 25% for every dollar above:
        1. Single $518,400
        2. MFJ $1,036,800
    vi. Tax Rate = 2018
        1. 26% up to
            a. $197,900 for all taxpayers except
            b. $95,550 for married filing separately
        2. 28% thereafter
    vii. Generally, only the foreign tax credit can reduce this tax
b. Self-employment tax
    i. Paid in place of employment taxes on wages (FICA)
    ii. 1/2 paid by employee, 1/2 paid by employer (same person)
    iii. Tax generally 15.3% of self employment income
    iv. Social Security tax = 6.2% up to S.E. income of
        1. 2020 - $137,700
        2. These amounts reduced by FICA taxes paid on wages
    v. Medicare tax = 1.45% x 2 on all S.E. income
    vi. 2015 new Medicare Surtaxes:
        1. Investment income 3.8% if MAGI > $250,000 married or $200,000 single
        2. Wages and S.E. income of 0.9% on wages or S.E. > $250,000 married or $200,000 single (per return, not per taxpayer)
c. American Opportunity and Lifetime Learning Credits
    i. Hope now four years and called the American Opportunity Credit
        1. - applies to first four years of college - up to $2,500 credit
            a. Limited to 100% of first $2,000
            b. 25% of the next $2,000
            c. As many taxpayers as qualified
            d. Goes to parents if student is a dependent unless they don't claim the dependent
    ii. Lifetime Learning 20% of the amount paid for post-secondary education
        1. maximum of $2,000 ($10,000 of qualified expenses)
        2. Only one per return
d. Estimated Taxes
    i. Forces taxpayers to pay their tax in installments during the year
    ii. Must pay in through either withholding or estimates on a quarterly basis, lower of
        1. 90% of current year tax
            a. regular tax
            b. alternative minimum tax

c. Self-employment tax

2. 100% of those taxes on the prior year's return, or if AGI > $150,000

iii. Penalty for failing to pay in the required amounts is = to a calculation similar to interest

iv. Due

1. April 15
2. June 15
3. September 15
4. January 15

v. Withholding can be treated as paid evenly throughout the year, regardless of when paid, or when paid

vi. Prior years overpayments, credited to the following year are treated as paid in by April 15th (assuming they had been paid in by then)

vii. Summary of Tax Numbers:

Must File for 2020	Standard Deduction	Personal Exemption	Must File	65	Must File	65 & Blind	Must File	
Single	12,400	-	$12,400	1,650	$14,050	$1,650	$15,700	Single
Joint	24,800	0	$24,800	1,300	$26,100	$1,300	$27,400	Joint
Married Separate	See Note 1	0	0	-	$0	$0	$0	Married Sep
Head Household	18,650	0	18,650	1,650	$20,300	1,650	$21,950	Head of Hou
Surviving Spouse	24,800	0	24,800	-	$24,800	-	$24,800	Surviving Sp
Dependent's Std. Ded	See Note 3	Greater of:	$ 1,100	or earned income +		$ 350		
		Maximum of	$ 12,400					
Notes:								
1. MFS the standard deduction is $0 for filing purposes								
2. Additional standard deduction for 65 or blind =								
	Single	$1,650						
	Married	$1,300						
3. Dependent's standard deduction								
	Min. > of:	$ 1,100	or Earned Income +	$ 350				
	Maximum	$ 12,400						