

TABLE OF CONTENTS

Chapter 1 | Introduction to Income Tax Planning

Learning Objectives	2
Introduction	2
Historical Perspective	2
Colonial Times.....	2
The Post Revolutionary Era	3
The Civil War	3
The 16th Amendment.....	3
World War I and the 1920s	5
The Social Security Tax	5
World War II	5
Developments after World War II	5
The Reagan Tax Cut.....	6
The Tax Reform Act of 1986	6
EGTRRA 2001 (The Bush Tax Cut)	7
The Patient Protection and Affordable Care Act (PPACA) of 2010	7
TRA 2010	8
The American Taxpayer Relief Act of 2012 (ATRA 2012)	8
The Tax Increase Prevention Act of 2014.....	8
Protecting Americans from Tax Hikes Act of 2015	9
Consolidated Appropriations Act of 2015	9
The Tax Cuts and Jobs Act of 2017	10
The Bipartisan Budget Act of 2018	11
SECURE Act of 2019 and The Taxpayer Certainty and Disaster Tax Relief Act of 2019	11
Income Taxes and the IRS	13
Overview of Federal Income Taxation	14
The Three Tax Systems	15
Basic Rules of Income Taxation	15
All Accretions to Wealth Constitute Income	15
For Every Deduction, There Must be an Inclusion.....	16
Triads of Income Taxation	17
Summary.....	22
Perspective of the Text	22

Chapter 2 | Working with the Tax Law

Learning Objectives	26
Introduction	26
Sources of Tax Law	26
Statutory Sources of Tax Law	28
How Tax Laws are Passed.....	29
Administrative Sources of Tax Law.....	30
Judicial Sources of Tax Law	33

Administration of the Tax System	34
Role of the IRS	34
Statute of Limitations	34
Interest and Penalties for Noncompliance	36
Penalties for Underpayment of Estimated Tax	38
Preparer Penalties	40
Audits	41
Dispute Resolution	42
Court System	45
Tax Research	50
Conclusion	50
Key Terms	51
Discussion Questions	53
Multiple Choice Problems	54
Quick Quiz Explanations	56

Chapter 3 | Fundamentals of Income Taxation

Learning Objectives	58
Tax Formula for Individual Taxpayers	59
Introduction	59
The Tax Formula	59
Income	61
Exclusions	61
Gross Income	66
Deductions	66
Adjusted Gross Income (AGI)	67
Taxable Income	70
Tax Rates on Taxable Income	71
Credit for Estimated Tax Payments	73
Other Tax Credits	73
Using the Tax Formula: The Anderson Family	74
Introduction to Individual Income Taxation	75
Tax Accounting Periods	75
Tax Accounting Methods	76
Filing Status	79
Personal and Dependency Exemptions	84
Calculation of the Standard Deduction for a Dependent	92
Kiddie Tax	94
Filing the Tax Return	96
Taxpayers Required to File a Return	96
Credit for Taxes Withheld	97
Basic Tax Planning Principles	100
Key Terms	103
Discussion Questions	105
Multiple Choice Problems	107
Quick Quiz Explanations	108

Chapter 4 | Gross Income From Personal and Investment Activities

Learning Objectives110

Introduction.....111

Subjecting Gross Income to Taxation.....112

 Tax Year and Accounting Method 112

 Gains Normally Taxed When Realized 112

Types of Gross Income and Exclusions114

Sources of Income117

 Investment Income 117

 Income from Personal Activities 117

 Employment Income..... 117

 Special Issues for Persons Living in Community Property States 118

Income from Investment Activities120

 Investment Items Included in Gross Income..... 120

 Investment Items Excluded from Gross Income..... 132

Income from Personal Activities142

 Personal Activity Items Included in Gross Income 142

 Alimony Paid 144

 Personal Activity Items Excluded from Gross Income..... 150

 Special Rules for Compensation for Injuries and Sickness..... 153

Summary and Conclusion156

Key Terms.....157

Discussion Questions159

Multiple Choice Problems160

Quick Quiz Explanations162

Chapter 5 | Gross Income from Employment

Learning Objectives166

Introduction.....167

Gross Income Related to Employment168

 Foreign Earned Income 171

Major Employer-Provided Fringe Benefits177

 Introduction to Fringe Benefits 177

 Taxation of Fringe Benefits 177

 Nondiscrimination of Fringe Benefits 178

 Individuals Who May Enjoy Benefits 178

 Health Insurance 178

 2010 Health Care Law 180

 Archer Medical Savings Accounts 181

 Health Savings Accounts 182

 Qualified Medical Expenses 184

 Life Insurance 184

 Disability Insurance 186

 Cafeteria Plans..... 187

 Flexible Spending Accounts (FSAs)..... 188

 Long-Term Care 190

Other Employee Fringe Benefits	191
Meals and Lodging	191
No-Additional-Cost Services	194
Qualified Employee Discounts	195
Working Condition Fringe Benefits	196
De Minimis Fringe Benefits	196
Qualified Transportation Fringe Benefits	197
Qualified Moving Expense Reimbursements	198
Qualified Retirement Planning Services	199
Athletic Facilities	200
Educational Assistance Programs	200
Dependent Care Assistance	201
Tuition Reductions Granted to Employees of Educational Institutions	201
Adoption Assistance Programs	201
Employee Achievement Awards	202
Combat Pay and Other Benefits of Military Personnel	203
Rental Value of Parsonage	203
Frequent Flyer Miles	203
Employer-Sponsored Retirement Plan Contributions and Distributions	203
Employee Deferrals	203
Employer Contributions	204
Retirement Plan Earnings	204
Retirement Plan Distributions	204
Income from Roth 401(k) and 403(b) Accounts	204
Employee Stock Options: ISOs & NQSOs	205
Government-Required Benefits	207
Unemployment Compensation	207
Workers' Compensation	207
Social Security	207
Modified Adjusted Gross Income (MAGI) for Social Security Income Inclusion	209
Summary and Conclusion	210
Key Terms	212
Discussion Questions	214
Multiple Choice Problems	215
Quick Quiz Explanations	217

Chapter 6 | Introduction to Deductions

Learning Objectives	220
Introduction	221
Classification of Deductible Expenses	221
Deductions for AGI (Above-the-Line Deductions)	222
Deductions from AGI (Below-the-Line Deductions)	223
Which Type of Deduction is Better – Above- or Below-the-Line Deductions?	223

Above-the-Line Deductions for Individuals 224

- Trade or Business Expenses 224
- Medical Savings Accounts (MSAs) and Health Savings Accounts (HSAs) 226
- Individual Retirement Accounts 229
- Moving Expenses 232
- Penalty on Early Withdrawal of Savings 233
- Educator Expenses 233
- Student Loan Interest 234
- Qualified Tuition and Related Expenses 235
- Alimony Paid 236

Deduction Issues for Employers and Employees 240

- Types of Businesses and General Deduction Rules 240
- Common Deductions for Employers and the Self-Employed 242

Deductions and Tax Planning 247

- For Employees 247
- For Business Owners 248
- For Investors 249

Summary and Conclusion 250

Key Terms 251

Discussion Questions 252

Multiple Choice Problems 253

Quick Quiz Explanations 255

Chapter 7 | Below-the-Line Deductions

Learning Objectives 258

Introduction 259

General Classification of Expenses 259

Medical Expenses 261

- Timing of Deduction 261
- Itemized Deductible Medical Expenses Overview 262
- Capital Expenses 262
- Nursing Homes and Special Schools 264
- Travel and Lodging Expenses 264
- Nondeductible Medical Expenses 264
- Above-the-Line Medical Expenses 264

Taxes 265

- Timing of Deduction 265
- Nondeductible Fines and Fees 268

Interest 269

- Qualified Residence Interest Deduction 270
- Investment Interest Deduction 274

Charitable Contributions and Deductions 276

- Qualified Charitable Organizations 276
- Additional Requirements for Deduction 277
- Gifts that Qualify for the Deduction 277
- Itemized Deduction Limitations 282
- Partial Interest Gifts 290

Casualty Losses	291
Casualty Loss Limitations	291
Business Casualty Losses	293
Miscellaneous Itemized Deductions	294
Deductions Not Subject to the Two Percent Floor (Tier I)	294
Deductions Subject to the Two Percent Floor (Tier II)	296
Deduction Clustering	302
The Qualified Business Income (QBI or Section 199A) Deduction	303
Introduction	303
Qualified Business Income	304
The QBI Deduction General Rule	304
Specified Service Trade or Business (SSTB)	305
Deduction Phase-Down and Transition	305
The 3 Tiers of Section 199A	306
Planning Applications	307
QBI Deduction for Qualified REIT Dividends and Publicly Traded Partnership Income	308
Summary and Conclusion	310
Key Terms	311
Discussion Questions	312
Multiple Choice Problems	313
Quick Quiz Explanations	315

Chapter 8 | Other Deductions, Penalties, and Loss Disallowance

Learning Objectives	318
Introduction	318
General Rules and Issues Related to Deductions and Loss Disallowance	318
Public Policy Limitations	319
Political Contributions	321
Excessive Compensation	321
Hobby Losses	322
Rental of Vacation Homes	328
Expenditures	334
Specific Deductions	334
Bad Debts	334
Worthless Securities	336
Section 1244 Stock	338
Losses of Individuals	339
Research and Experimental Expenditures	341
Net Operating Losses	342
Loss Limitation for Individuals	342
Depreciation	343
Penalties	344
Excess Contributions Penalty	344
Early Distribution Penalty	345
Late Distribution Penalty	346

Other Loss Disallowances – Temporary and Permanent 347

 Section 1031 Exchanges Resulting in a Loss are Not Immediately Deductible..... 347

 Wash Sales 347

 Related Party Transactions 348

 Gifts Below Fair Market Value..... 349

 Sale of Personal Assets for Loss 349

Conclusion 349

Key Terms..... 350

Discussion Questions 351

Multiple Choice Problems 352

Quick Quiz Explanations 354

Chapter 9 | Tax Credits

Learning Objectives 356

Introduction..... 356

 Nonrefundable Tax Credits 357

 Refundable Tax Credits 359

 Tax Credits vs. Tax Deductions 360

 Tax Policy Issues 360

 Tax Credit Requirements 361

 Nonbusiness and Business Tax Credits 361

Nonrefundable Credits of A Personal Nature 361

 Foreign Tax Credit..... 361

 Credit for Child and Dependent Care Expenses 363

 Credit for the Elderly or Disabled 369

 Education Credits (American Opportunity Tax and Lifetime Learning Credits) 369

 Retirement Savings Contributions Credit (Saver’s Credit)..... 374

 Child Tax Credit (IRC Section 24)..... 375

 Other Dependent Credit (ODC) 379

 Residential Energy Property and Residential Energy Efficient Property Credits 380

 Qualified Adoption Expenses Credit..... 381

Refundable Credits 383

 Credits for Taxes Paid..... 383

 Earned Income Credit..... 384

General Business Credit 386

 Investment Credit 388

 Work Opportunity Credit 388

 Credit for Increasing Research Activities 389

 Low-Income Housing Credit 389

 Disabled Access Credit..... 390

 Small Employer Pension Plan Startup Costs Credit..... 390

 Employer-Provided Child Care Credit 390

 Tax Credits from the 2010 Health Care Legislation 391

Key Terms..... 392

Discussion Questions 394

Multiple Choice Problems 395

Quick Quiz Explanations 397

Chapter 10 | Basis Rules, Depreciation, & Asset Categorization

Learning Objectives	400
Introduction to Basis	401
Calculating Gain or Loss	401
Purpose of Basis	402
Uses of Basis	403
Determining Basis	403
Cost Basis	403
Adjustments to Basis	405
Basis Rules for Personal Use Assets	408
Special Basis Rules	409
Basis of Inherited Property	409
Basis of Gifted Property	411
Basis of Property Transferred Between Spouses or Incident to Divorce	414
Related Party Transactions (Sales, Gifts, and Basis-IRC Section 267)	415
Basis of Jointly Held Property	418
Depreciation	418
Purpose	418
Methods of Depreciation	419
Bonus Depreciation (Additional First Year Depreciation)	424
Amortization of Intangible Assets	426
Depletion of Natural Resources	427
Special Depreciation Issues	427
Categorizing Assets for Income Tax Purposes	435
Capital Assets	435
Ordinary Income Assets	438
Section 1231 Assets	439
Summary	441
Key Terms	442
Discussion Questions	444
Multiple Choice Problems	445
Quick Quiz Explanations	447

Chapter 11 | The Taxation of Capital Assets

Learning Objectives	450
Introduction	450
Realization and Recognition	451
Sale or Exchange Requirements	451
Calculation of Gain or Loss	453
Recognition Rules	455
Capital Asset Holding Periods and Tax Rates	459
Holding Periods	459
Capital Gains Tax Rates	464
Capital Gains and the AMT	471
Determining Net Capital Gains and Losses	471

Limitations on Recognition of Capital Losses 472
 Small Business Stock (Section 1202) 475
Summary 475
Key Terms 476
Discussion Questions 477
Multiple Choice Problems 478
Quick Quiz Explanations 479

Chapter 12 | Business Assets

Learning Objectives 482
Introduction 482
Ordinary Income Assets 482
Section 1231 Assets 484
 Benefits of Section 1231 484
 The Catch - Depreciation Recapture 485
Recapturing Depreciation on Personal Property (Section 1245) 487
Recapturing Depreciation Taken on Real Estate (Section 1250) 495
The Impact of Taxation of Business Assets on Planning 502
 Gifts 502
 Nontaxable Exchanges 503
 Transfers at Death 504
 Charitable Contributions 504
 Installment Sales 505
 The 5-Year Lookback Rule 507
Key Terms 509
Discussion Questions 510
Multiple Choice Problems 511
Quick Quiz Explanations 513

Chapter 13 | Nontaxable Exchanges

Learning Objectives 516
Introduction 516
Like-Kind Exchanges (Section 1031) 517
 Assets Subject to Like-Kind Exchange Treatment 517
 Requirements for Like-Kind Exchange Treatment 518
 Related-Party Transactions 521
 Tax Consequences of Like-Kind Exchanges 522
Exchange of Stock for Property (Section 1032) 528
Involuntary Conversions (Section 1033) 528
Insurance Policies (Section 1035) 531
Corporate Recapitalizations (Section 1036) 534
Reacquisitions of Real Property (Section 1038) 535
Transactions Between Spouses Incident to Divorce (Section 1041) 537

Sale of Personal Residence (section 121)	537
Death Benefits and Loans from Life Insurance	543
Distributions from Roth IRAs and Roth Accounts	545
Conclusion	545
Key Terms	546
Discussion Questions	547
Multiple Choice Problems	548
Quick Quiz Explanations	550

Chapter 14 | Passive Activity Rules

Learning Objectives	552
Introduction	552
Background to the Passive Activity Loss Rules	552
Net Investment Income (2013 and Beyond)	554
Application of the Rules	556
Three Types of Income	556
Passive Activities	557
Material Participation	558
Grouping of Passive Activities	559
Limitations Imposed on Passive Losses	560
The Basis Limitation	560
At-Risk Rules	560
Passive Activity Loss Rules	563
Passive Activity Loss Rules Upon Transfer	567
Exceptions to the Passive Activity Rules	569
Rental Activities	569
Real Estate Exceptions	571
Passive Credits	576
Conclusion	576
Key Terms	577
Discussion Questions	578
Multiple Choice Problems	579
Quick Quiz Explanations	581

Chapter 15 | The Alternative Minimum Tax

Learning Objectives	584
Introduction	584
How the AMT Works	585
Adjustments and Preferences	588
Personal and Dependency Exemptions and the Standard Deduction	588
Itemized Deduction Changes	588
Investment-Related Changes	591
Business-Related Changes	594
Miscellaneous Adjustments	595

Corporations and the AMT596
 Conclusion596
 Key Terms.....597
 Discussion Questions598
 Multiple Choice Problems599
 Quick Quiz Explanations600

Chapter 16 | Business Entity Selection and Taxation

Learning Objectives602
Introduction.....602
 Ease and Cost of Formation 602
 Complexity of Management and Governance 603
 Transferability and Dissolution 603
 Liability Protection for Owners’ Personal Assets..... 603
 Reporting Requirements and Taxation 604
Sole Proprietorships.....605
 Formation 605
 Interest, Disposal of Interest, and Dissolution 605
 Capital 605
 Liability 605
 Management/Operations 605
 Income Taxation and Payroll (Social Security) Taxes 605
General Partnerships.....614
 Formation 614
 Interest, Disposal of Interest, and Dissolution 614
 Capital 614
 Liability 615
 Management/Operations 615
 Income Taxation and Payroll (Social Security) Taxation 615
 Partners’ Basis in a Partnership 616
Limited Partnerships (LP).....621
 Formation 621
 Interest, Disposal of Interest, and Dissolution 621
 Capital 621
 Liability 621
 Management/Operations 622
 Income Taxation and Payroll (Social Security) Taxes 622
Limited Liability Partnerships (LLP).....622
 Formation 622
 Interest, Disposal of Interest, and Dissolution 623
 Capital 623
 Liability 623
 Management/Operations 623
 Income Taxation and Payroll (Social Security) Taxes 624

Family Limited Partnerships (FLP)	624
Formation	624
Interest, Disposal of Interest, and Dissolution	625
Capital	626
Liability	626
Taxation	627
Limited Liability Companies (LLC)	628
Formation	628
Interest, Disposal of Interest, and Dissolution	628
Capital	628
Liability	628
Management/Operations	628
Income Taxation and Payroll (Social Security) Taxes	629
C Corporations	632
Formation	632
Interest, Disposal of Interest, and Dissolution	632
Capital	632
Liability	632
Management/Operations	632
Income Taxation and Payroll (Social Security) Taxes	633
S Corporations	636
Interest, Disposal of Interest, and Dissolution	636
Capital	636
Liability	636
Management/Operations	636
Income Taxation and Payroll (Social Security) Taxes	636
S Corporation Owners' Basis	637
Comparison of S Corporations and LLCs	641
TCJA 2017	645
The Qualified Business Income (QBI or Section 199A) Deduction	645
Calculating the QBI Deduction	645
W-2 Wage Limitation	647
Specified Service Trade or Business (SSTB) Limitation	648
Real Estate Safe Harbor	649
Tax Analysis: C Corporation versus Pass-Through Entity with QBI Deduction	650
Protecting Owners from Each Other	651
Protecting Minority Shareholders/Members	651
Elements of Shareholder/Partnership Agreements	651
Issues Regarding Additional Capital Required	651
Key Terms	652
Discussion Questions	654
Multiple Choice Problems	655
Quick Quiz Explanations	657
Appendices	
Tax Rate Schedules	659
Glossary	663
Index	675