Income Tax I
Fall 2021
Final Exam
Samples of Good Essay Answers

QUESTION 37

Sample No. 1

Woodacre

Woodacre is a vacation home. Woodacre is also a rental.

If Woodacre had any mortgages, the interest of the mortgages would be deductible under 163(h)(3) as a qualified residence and vacation home. A vacation home is one that is used for at least 14 days (unless rented, as is the case here), or occupied for at least 10% of the time that it is rented out for. 280A(d). Because Woodacre is used for 100 days and it is rented out for 100 days, they satisfy the second prong of the test and Woodacre qualifies as a vacation home.

Rental properties are considered properties maintained for profit and therefore, their expenses are deductible as business expenses under 162 and 262. However, because Woodacre is also used as a vacation home, the expenses associated with its maintenance are personal in nature and would living expenses under 262. Congress has resolved this issue with 280A(e), which says that expenses attributable to rentals are apportioned to the days rented and days used, respectively. Because it is used for the same amount of time that it is rented, Hal and Ward may deduct 50% of the Woodacre expenses. The time that Woodacre is vacant is not relevant to this equation.

Further, if the costs of maintaining Woodacre produce losses, they are only deductible to the extent of the rental income produced by the property. 380A(c)(5).

In sum, the couple may deduct 50% of their Woodacre expenses against the rental income produced by the property.

Any money received from renting Woodacre out is ordinary income and taxed as such. 61(a)(5).

The Divorce

There is no income from the divorce. Transfers of property between married couples or transfers incident to divorce are treated as gifts per section 1041(a). The transferee's new basis is the transferor's basis prior to the transfer of property. Ward's new basis in Woodacre is thee same as Hal's basis upon transfer: $200,000. This is the basis that Ward will use to calculate gains if Ward sells the property.

If Ward had continued to rent Woodacre out, the money received would have been ordinary income to Ward. 101(b). However, he stopped the rental process and it is no longer income. Additionally, because he is no longer using the property for a rental business, any expenses attributed to the property are no longer deductible under 162 or 262.

Hal does not receive income when Hal receives $40,000 from Ward's bank account. The money is not going to produce any additional income and it is considered a gift because it is incidental to a divorce. 1041.

Ward's Death

When Ward died and passed his property to Sam, Sam received some gross income.

The transfer of Woodacre was not gross income. This is because gross income does not include the value of property acquired by devise or inheritance. 102(a). Additionally, the basis of the property—Woodacre—reset upon Ward's death. Upon death, the basis of any property (that has a basis) transferred is reset to the fair market value of the property at the date of the decedent's death (there are estate tax elections under 2031 et seq. but these are outside the scope of the class). 1014(a). The fair market value is defined by Treas. Reg.1.16-2(d)(1) as the amount the property would be sold to a hypothetical buyer by a hypothetical seller. Woodacre has a fair market value of $625,000 at the time of Ward's death. Therefore, Sam now has ownership of Woodacre with a basis of $625,000 with no impact to his gross income.

The passing of Chloe's note to Sam from Ward was not income either. However, once Chloe paid Sam, the money Sam recieved is income to Sam. This is because the 102 exclusion does not apply to income from property referred to in section 102(a). 102(b). Therefore, Sam must include the money received from Chloe as income when the amount is realized a month after Ward's death. Additionally, because it is money paid in exchange for services, and not a capital gain, Chloe's fee will be taxed as ordinary income.

Woodacre's Condemnation

In 2025, Woodacre is subject to an involuntary conversion due to condemnation. Section 1033 regulates the tax effects of involuntary conversions. Generally, when a property is condemned and the taxpayer takes money for the conversion, it is treated as a sale. If Sam had done this, then he would be calculating his gain using 1011 (amount realized $700,000 - basis $625,000 [reset at Ward's death per s1014] = $75,000 capital gains). However, given the timing of the transactions (there are only 2 years between the conversion and the repurchase), it seems that Sam likely took a 1033(a)(2)(A) election. A taxpayer may take this election if they repurchase similar property within two years after the close of the first taxable year that any part of the gain is recognized or, if they are lucky, longer by the Secretary's permission. 1033(a)(2)(B). Because the old property is not the exact same price as the new property, Sam will have income consequences. His new basis will be the cost of the new property minus the gain not recognized on the transaction. Because Sam is pocketing $20,000 of his $75,000 gain, his unrecognized gain on the transaction is $55,000. Therefore, his new basis is ($680,000 minus $55,000 equals $625,000) $625,000. 1033(b). The $20,000 that Sam does not put towards the cost of new property is income taxed as a capital gain.

Sample No. 2

Since Hal and Ward are a married couple filing jointly they have larger tax brackets than single filers and their income is computed together as a whole.

Woodacre (Rental property in 2021)

A vacation home's property taxes are deductible. Under Sec. 162 a taxpayer can get a deduction for when rent out the house, but no deduction under 280A(a) for when they use it themselves as a residence. The deduction is based off the # of days rent out vs the # of days in total it was used. So the ratio would be 100/200 or 1/2. They would be able to deduct 1/2. It is a partial allowance that looks not the intent of the homeowners but their actual use of the property. Under Sec 280A(g) if they rented out less than 15 days then their would be no deduction but since it was rented out for 100 days they do not fall under that section. So in total Hal would be able to deduct 1/2 of the maintenance, repair, insurance and HOA dues for Woodacre. Rental income is ordinary. The basis in woodacre in 2021 is unknown as their is not enough information. Further rental income is a passive activity and can only be deducted against passive income.

Divorce

Divorce has no tax consequence, the martial status of taxpayers will be determined at the end of the yr and so Hal and Ward will be considered single in 2022. Sec. 1041 transfer of property to a spouse or ex spouse if for a divorce is automatically treated as gift. There is no income tax for property distribution it is looked at as a gift and so Ward receiving Woodacre is not included in his gross income. As it is a gift there will be a carryover basis, and so War'd basis in the property will be Hal's old basis of $200,000, not its FMV of $625,000. When Ward stops using it is a rental property it will no longer receiving a business/rental deduction, unless Ward holds it for investment purposes or further deductions will depend on its use. It seems to be used for recreation which is personal use and so no deductions. And Hal receiving $40,000 is also a gift and not included in Hal's gross income.

Will Transfers

Death is not a realizing event and so the transfer of Ward's property to Sam will not be included in Sam's gross income, nor will it be realized by the estate. Under Sec. 1014 property that is transferred in a will receives a stepped up basis instead of a carry over one. As such Sam's basis in Woodacre will be its FMV at the time of Ward's death. So Sam's basis is $625,000. As woodacre is continuing to be used for personal and recreational purposes there are no deductions.

Chloe's payment is income in respect of decedent and as such it wasn't received while Ward was alive and was not income to Ward or his estate when Ward died. The basis of the payment is therefore 0 to the estate, this payment will not go on the estate tax return. This type of income gets a carryover basis and as such Sam's basis in the payment will be what it was worth when received, as its a payment an no one has paid tax on it it will be the full value of what is paid, when Chloe pays it to him. It will be ordinary income as it was in regards to services.

Condemnation

Replacement of property is treated as a sales of property, and is treated as a realizing event (Sec. 1001), if not for the exceptions under 1033. As this is a condemnation it is an involuntary conversion, since it is involuntary and there is a gain a taxpayer can elect not to pay but only if they buy replacement property. Under the "rollover" provision Sam is allowed to get the money and not use it for a certain specified period. Such period is the date of disposition or date of threat whatever earlier. Most circumstances it is when the taxpayer gets the money. This periods ends 2 yrs after the close of the taxable year in which the gain was realized. This gain was realized in 2025 so Sam has until the close of 2027 to buy a replacement property. Since he does buy property in 2027 the money received and spent on a replacement house is not recognized The replacement property must be similar or related in purpose, since its real property its a question of like kind a home in the woods vs a vacation cabin is of like kind. It needs to be like kind in nature or character not grade or quality. The gain on this would be the amount realized over cost of replacement, basically the proceeds not invested in the new property is boot. As Sam received $700,000 for Woodacre and used $680,000 he has boot of $20,000 which is taxable gain. As woodacre was not property held as a business and the replacement of property is treated as a sale this would be the sale of a capital asset and the $20,000 gain would be taxed at capital gain rates. Sam will have a $680,000 basis in the cabin.

Sample No. 3

2021 Rental

Given that Woodacre is used both as a rental and recreational property, under 280A, there is a partial allowance for deductions for maintenance, repair, insurance, and HOA dues that are incurred in connection with Woodacre. The test for how much the allowance is depends on the number of days of each type of use— not intent. In this case, the 165 days of vacancy does not factor into the calculation. The 100 days of rental and 100 days of recreation create an even 50-50 split of each type of use. Thus, Hal may deduct 50% of the appropriate expenses incurred in relation to Woodacre during 2021. But all of Hal's deductions will be capped at the amount of rental income Woodacre generates— the property may not be used as a tax shelter.

2022 Divorce

As an alternative to FMV, marital rights/property are worth for what they are traded. In this case, because Ward receives Woodacre from a spouse (or ex-spouse within a year of dissolution), under 1041 Ward does not recognize a gain on the transfer. Ward's basis in Woodacre carries over from Hal. So Ward's new basis in Woodacre is $200k. When Ward stops renting Woodacre to tenants, Ward loses the ability to deduct the expenses Hal was able to deduct. That said, Ward remains able to deduct mortgage interest as well as any state or local taxes he pays related to Woodacre, so long as he is not choosing instead to deduct sales tax in the state.

When Hal receives $40k from Ward's bank account, under 1041 Hal does not recognize a gain on the transfer.

Ward's Death: Woodacre

When Ward dies and leaves his property to Sam, under 1014 Sam receives a stepped-up basis in all the assets he inherits. In terms of Woodacre, this means Sam's basis becomes the FMV of the property at the time of Ward's death: $625k.

Ward's Death: Account Receivable

After Ward dies, because Ward had yet to receive payment for his services for Chloe, Chloe's payment becomes IRD. This means that Sam, as the inheritor, under 1014 must pay income tax on the (ordinary) gross income as well as any relevant state/local tax during the year in which the payment was received. This makes sense in general because Ward never paid any tax on the payment he was to receive from Chloe, but that does not mean the extra tax will sting any less for Sam.

Condemnation

Under 1033, when a property is condemned, a taxpayer may elect to replace the property and be eligible to avoid paying taxes on the payment for the condemnation. That said, an important and applicable condition is that the replacement must occur within two years. Another condition is that the replacement property must serve a similar purpose. In this case, Sam could have had a successful 1033 election when he replaced Woodacre with the cabin. The election would allowed Sam to carry over the $625k basis Sam had in Woodacre to the cabin, receiving income on only the difference between the payout ($700k) and the purchase property price ($680k)— in which case Sam would have only $20k of (capital) gain. But because Sam waits longer than two years (early in 2025 to late in 2027 is more than two years), Sam is not eligible to elect for 1033. This means that Sam has income of the difference between the $700k payment and his basis $625k— $75k of (capital) gain upon the payment for the condemnation of Woodacre.

When Sam buys the cabin, his basis is his cost, so his basis in the cabin is $680k.

QUESTION 38

Sample No. 1

Business Attire

Eva's reimbursement for business attire will be considered ordinary income to her as it was in compensation for her services. For clothing expenses to be deductible to an employee they must be the type specifically required for employment not generally adaptable to general usage and is not so worn (See Pevsner). For the reimbursement for her employer to be deductible the cost of the clothes had to have been deductible to Eva. Even though the work required the specific clothes be worn, traditional business attire is adaptable to general usage, going to nicer places, dressing up, taking pieces to mix with more casual pants, shirts etc. And while business attire could be a bit high flying in some places, there are many place business attire is acceptable for daily life and general usage. (More the east coast). As the clothes expense wasn't deductible to Eva if she paid for them the reimbursement is income, further it is not included with any of the fringe benefits (Sec. 132) or other code section. As such she will be taxed on her salary + the 2,000 reimbursement as ordinary income.

Stock

Eva is receiving a bonus and not an option. She is receiving property in compensation for her services as such it falls under Sec. 83. 83 makes it clear that the value will not be included in gross income until the rights of the person are vested and not subject to substantial forfeiture. So despite the fact Eva receives the bonus in 2021 due to the fact her retention of the stock is contingent on her continuing to work there, there is a substantial risk of forfeiture. There is no tax till her rights are vested. So Eva will not be taxed on her bonus till her rights vest in Nov. 30, 2023. This is not a stock option but a bonus and as such Eva will be taxed the Fair market value of the stock when it vests over the price paid, and since it was a bonus she paid no price. As such Eva has taxable ordinary income in the amount of $14,000 (as $14 for 1,000 shares). Eva could chose to elect under 83(b) and deduct the FMV of the stock when she received the bonus and be taxed at the current value and as such it would be $10,000 in ordinary income she would be taxed on. When Eve decides to sell her shares in 2025 her basis in the stocks (if she didn't take the election) would be $14,000 and her amount realized would be $17,000, so her gain on the sale would be $3,000. Is she did take the election that gain would be $7,000. To be capital it must be the sales or exchange of a capital asset. Sec. 1222. As this is sales of stocks (which doesn't fall under the definition by subtraction that is Sec. 1222) it is a capital asset and she held it for more than a year so a long term capital gain and so it will be taxed at capital gains rates.

Education Expenses

Tuition reimbursement

Under Sec. 117 allows for qualified scholarships but this doesn't apply to Eva as this is not a scholarship, as it is not set up properly, their is no policy (we are told of) and most importantly the scholarship doesn't apply to graduate level schooling. However if we look to Sec. 127 Educational assistance programs an employer can subsides some of your tuition up to $5,250 if it is pursuant to the requirements of 127. We don't have many details but the $5,000 reimbursement likely falls under this exclusion and as such will not be included in Eva's gross income.

Deductibility Reg 1.162-5

Tuition is not normally a deductible business expenses. For it to be deductible it must maintain or improve require skills in the taxpayers existing trade/business. It can't be entry level education for existing trade/business. It can't qualify the taxpayer for a new trade or business. But the taxpayer can deduct is its is continuing education in their field. The training of business and art skills for someone working as a a sales associate in an art gallery could be argued to not be qualifying her for a new field, and it is not entry level education as she already works there and is being encourage by her employer. One could say it could open her up for a management position but it is hardly a new field. The two issues for her getting these expenses deducted are the classes not related to her field and the fact she doesn't receive the promotion. However, Allemeier was able to deduct his MBA expense and one of the factors in his favor was the reality he got promoted before receiving his MBA. Here Eva has the opposite but she could argue that as such the education is not qualifying her for something new and that it is continuing education in her field as it was encouraged by her employer though it did not change her status in the company or her field of work. Though there are some serious issues on whether or not her management position was contingent on the education. If the promotion was contingent on the education it will likely be found to qualify her for new field and she will not be able to take a deduction. UnderSec. 254 there is also a credit available for out of pocket expense that could be available to her.

Debts

Eva's various debts were not income to her when she got them as she is required to pay them back and as such there is no accession to wealth as is required by Glenshaw glass. When Eva pays back the principal on these loans there is further no tax consequence, no deduction in basis, because the money being used to pay back the loan is what is being taxed.

Under 163(a) all interest paid within the taxable year on indebtedness is allowable as a deduction, however many exceptions have been put in place. Specifically under 163(h) personal interest is not deductible and as such Eva's credit card loan and auto loan interest payments aren't deductible. However any qualified resident interest, ie home mortgage interest, is deductible. Specifically acquisition indebtedness, a loan for improving a qualified residence secured by the residence is deductible with a 1 million limit. So her mortgage to improve her homes bathroom is deductible. However home mortgage interest is deductible below the line, as it is not listed in Sec. 62, and can only be taken if Eva itemizes her deductions. (163 however is lucky enough to not count as a miscellaneous deduction which are not allowed anymore)

Under Sec. 221 student loan interest is also deductible but has to be for a qualified educational loan. Since Eva got the loan when she was an undergraduate student it is likely to fall under the requirements of 221. The deduction can't exceed $2,500. This is an above the line deduction as it is listed in Sec. 62 and she can take it whether or not she itemizes.

Charity Work

For charitable contributions to be deductible you have to have the right kind of recipient under sec. 170(c) ie. created in US, operated for the right purposes, not lobbying etc. As we are told it is a charity we assume that it is a proper recipient. However an important requirement of receiving a Charitable contribution deduction is the contribution must be of something other than just time and services. As such the services she provides is just her time and the $8,000 is not deductible. However there are deductions for out of pocket expenses such as the gas Eva contributes to deliver food. 170 is a below the line deduction and if Eva wishes to receive the deduction she will have to itemize. There is an exception for 170(p) but that is for cash contributions only and only up to $600.

Sample No. 2

<u>I. Reimbursement for Business Clothing</u>

Work-related clothing is deductible if it is (1) of a type specifically required as a condition of employment, (2) not adaptable to general usage as ordinary clothing, and (3) not so worn. Here, Eva is provided reimbursement for "traditional business attire." Unfortunately for Eva, traditional business attire *is* adaptable to general usage as ordinary clothing. Whether Eva would wear it outside of work does not matter. *Pevsner*. By reimbursing Eva for this expense, Rtco is providing her with a taxable benefit. She will have to report the $2000 as additional income.

<u>II. Stock Bonus</u>

§ 83 prescribes rules for property transferred in connection with performance of services. If property is given as compensation (as it was here), then the recipient is taxed on the fair market value minus the amount paid. The employee must make an election to be taxed on the **current value** of the stock or else they will be taxed in the first taxable year where their rights are not "subject to a substantial risk of forfeiture."

First, let us assume that Eva elects to be taxed on the stock in the year it was given. She would be taxed on $10,000 ordinary income. When Eva sells the stock in 2025, she will recognize a capital gain of $7,000 on her sale. Capital gains are taxed at more favorable rates, which is great for Eva.

Second, let us assume that Eva misses the opportunity to elect to be taxed on the stock in the year it was given. Under this circumstance, she would be taxed two years later, at $14,000 ordinary income. When Eva sells the stock, she will realize a $3,000 capital gain.

Without knowing Eva's full financial picture, it is hard to say which of these options will be better and by how much, but my best guess is that making the election under § 83 to be taxed on the stock in 2021 will be a better outcome. Eva would not want to risk facing the same tax burden as the taxpayer in *Alves*.

One final note: The employer deduction will be for the amount that the employee lists as income in the same taxable year in which the employee lists it as income.

III. Tuition Reimbursement

From the facts, it appears that Eva has paid for some of her education-related expenses and her employer has paid for others.

Taking Eva's payments first: The general rule is that education-related expenses are only deductible if they go towards continuing education for a job you already have. Treas. Reg. § 1.162-5 clarifies that the following requirements must be satisfied: (1) Education must maintain or improve required skills in existing trade or business, (2) education cannot be entry level education for an existing trade or business, and (3) education cannot qualify taxpayer for a new business.

Eva's courses may fall into this category. Though, there is a question of whether taking these classes is qualifying Eva for a new role in management as opposed to sales. In *Allemeier*, the taxpayer was promoted even before he finished the degree which tipped in his favor in determining that it really was not qualifying him for a new business. Here, the IRS might argue that the purpose of Eva taking those courses was to qualify her for a new role a la *Namrow*. Eva's best response to that might be that her employer still reimbursed her tuition expenses despite *not* promoting her (though the timing of payment may vitiate this argument). There is still the issue that Eva took some courses not related to art and management. These courses probably will not satisfy the aforementioned IRS requirements, and therefore, will not be deductible.

Employers may offer their employees a variety of benefits -- some are not taxable, and others will be taxable as income. Under § 127, employer scholarships are capped at $5,250 for employees only, and are excluded from an employee's gross income. Rtco's reimbursement falls under this level. However, § 127(a)(2) explains that such a program must be found by the IRS to not be discriminatory. From the facts, it appears that Eva was singled out for this reimbursement, as opposed to it being a benefit offered to all employees meeting non-discriminatory criteria. As such, this reimbursement is likely to qualify as income to Eva.

Finally, every taxpayer can take advantage of the one-time Hope credit under § 25A.

IV. Personal Interest Deductions

Generally, personal interest deductions are disallowed under § 163(h). With this in mind, we will review Eva's debts and determine whether they will impact her tax obligations.

A. Student Loan

Eva's student loan interest is deductible within the limits prescribed by § 221 (and it is an above the line deduction). However, the deduction cannot exceed $2500. Additionally, the deduction cannot be taken if Eva's AGI is over $50,000 a year (indexed for inflation). More information is needed to calculate Eva's AGI and determine whether she is eligible for this deduction.

B. Auto Loan

Eva cannot deduct interest for her auto loan. There might be a wild argument to be made that the interest should be deductible given that she needs to use the car to commute to/from work. However, the cost of commuting is not deductible.

C. Credit Card Debt

Eva cannot deduct interest for her credit card debt. That is firmly in the "personal expense" camp.

D. Mortgage Loan

Under § 163(h), Eva may be able to take a deduction for interest on a mortgage or a loan borrowed to substantially improve a home, up to a limit. In order to take advantage of these deductions, Eva will have to show that her uncle's home is a qualified residence. From the facts, it is unclear whether Eva uses the inherited home as a residence, or whether she is just fixing it up in order to sell it. More facts are needed to determine whether she can take a deduction, or whether the improvements are capital expenditures that she will just need to recapture at the time she sells the home.

V. Volunteer Work

From the facts, it appears that the charity for which Eva volunteers is a public charity that would be eligible to receive tax deductible contributions under § 170. However, the time Eva spends *volunteering* for a local charity is not deductible given that personal services are not deductible. However, Eva may take as a charitable deduction the cost of unreimbursed travel expenses incurred in connection with her volunteer work. The IRS has tables that provide instruction on how much Eva may deduct for driving to deliver food for charity. Should Eva elect to make a cash contribution, she would be able to receive a below the line deduction of at least $300 per § 170(p), possibly more depending on whether or not she elects to itemize or take the standard deduction. Charitable deductions are also limited by AGI -- however, with the amounts discussed here, it seems unlikely that Eva will run into any issues where those limits are concerned.

Sample No. 3

Work Clothes

Generally, expenses associated with the production of income are deductible under 212. However, clothing seems to fall into both categories in this case. Eva would need to wear clothes even if she were not at work, so it could be considered a personal expense. The fact that her employer requires that she wear particular clothes could push this expense into the deductible realm of production of income. Clothing expenses are only deductible if 1) the clothing is of the type specifically required as a condition of employment, 2) it is not adaptable to general usage as ordinary clothing, and 3) it is not so worn. Here, Eva's employer requires traditional business attire which satisfies requirement number 1. Eva runs into issues with numbers 2 and 3. Under the Pevsner objective test, Eva's personal lifestyle or personal taste in clothing are irrelevant. If she can wear her traditional business attire in other situations, which she can, then she cannot deduct. The only kinds of clothing that are not applicable to other situations are very limited, like a chicken suit outfit worn by a sign shaker for KFC, or some other outlandish uniform-type clothing. Regular business clothing will not satisfy this requirement. Therefore, Eva's $2,000 reimbursement from her employer is ordinary income.

Stock Bonus & Sale

When Eva is awarded the bonus in 2021 from her employer, the fair market value of the stock would typically be included in her ordinary income under 102(c) because gift treatment for transfers by an employer to an employee is categorically precluded. However, if there is a substantial risk of forfeiture, and if she cannot transfer the stock, then her rights in the stock are not substantially vested and she will not have to report the income until vesting. Here, we have no facts concerning transfer restrictions on the stock, but if Eva found a buyer for the stock the buyer would presumably have to purchase it with the potential for forfeiture if Eva quits working there before 11/30/2023. Therefore, Eva will not have any gross income in 2021 as a result of the stock bonus. When November 30, 2023 comes around and Eva is still employed at Rtco, her stock becomes fully vested and Eva will have income equal to the fair market value of the stock as of 11/30/2023 = $14 per share. This will become her basis in the stock, so when she sells it for $17 per share in 2025, she will have a capital gain of $3 per share realized and recognized on which she will have to pay the tax. It''s good for Eva that it's a capital gain because the maximum rate for that is 20%, rather than the ordinary tax rates which max out at 37%. We don't know exactly what Eva's tax brackets are, but capital gains are taxed at favorable rates compared to ordinary income.

If Eva is feeling particularly optimistic about her stock's outlook for appreciation (and is quite certain that she will continue working there long enough for the share to vest) when she gets the award in 2021, she can make an 83(b) election within 30 days of the award. This election will allow her to claim the income in 2021 at the $10 per share value. This means that she will have to pay the tax sooner, but she could save quite a bit on the taxes that she'll pay at the ordinary income rates because she's only having to pay on the $10 per share price instead of the tax on $14 per share. However, some really bad stuff could happen to Eva if she makes the 83(b) election. If she quits working before she gets the shares vested, she doesn't get the stock that she's paid income tax on, AND she doesn't get a deduction for it later. In addition, her basis in the stock will be $10 per share, so she'll have to pay capital gains on the $7 per share increase when she sells in 2025.

Tuition

Under IRC 127, an employer may provide tuition assistance to an employee up to $5,250 per year and the employee does not have to report it as income. In addition, the tuition doesn't have to pay for education that's related to the employer's business. There are a bunch of requirements to qualify for this kind of tuition assistance: 1) there must be a separate written plan for the exclusive benefit of the employee, 2) the plan cannot be discriminatory, 3) not more than 5% can be spend on principal shareholders or owners, 4) it cannot provide a monetary benefit as an alternative, and 5) reasonable notification must be given to the employees. We don't have enough facts about the employer's tuition reimbursement to decide if it qualifies under 127.

Assuming that the tuition reimbursement doesn't qualify under 127, Eva will have to report it as ordinary income. Under 162, Eva may be able to deduct the tuition as an education expense, but only under certain conditions. For example, under Reg. 1.162-5, 1) education must maintain or improve required skills in existing trade/business, 2) can't be entry level education for existing trade/business, 3) can't qualify taxpayer for a new trade or business. Here, we are told that some of the classes she takes are not related to art or business, so it doesn't qualify under item 1. In addition, even if all her classes were about business and they qualified her to take a new position in Rtco that she was otherwise not qualified for, that would be considered "entry level education." Therefore, Eva will not be able to deduct the tuition that she paid to reduce her income tax burden.

Eva's Debts

As discussed above, Eva cannot deduct her tuition expenses to reduce her income tax burden. When she makes payments on her student loans, she may deduct the interest she pays under 221 as an above-the-line deduction, meaning she gets the benefit of this deduction regardless of whether or not she itemizes her deductions. She does not get any deduction for her repayment of principal on her student loans. Assuming that Eva doesn't use her auto in a business capacity and only uses it for personal use, she does not get any deductions for her interest or principal payments on her auto loan. Similarly, assuming that her credit card debt is resulting from purchases of a personal nature, rather than business expenses, she will get no deduction for interest or principal payments on her credit card either. The residence that she inherited from her uncle presumably has an "equity" loan, which she used to make capital improvements to that property. She won't get to deduct the interest or principal on those payments because the loan wasn't used to acquire the property. Deductions for home equity indebtedness are temporarily suspended (2018-2025). However, the amounts that she spent to improve the residence (namely the cost to remodel the kitchen and bathroom) will increase her basis in the property. Therefore, Eva's basis in the residence will be the FMV of the property as of the date her uncle died (or 6 months later if her uncle's executor made the election to value the estate's property as of the date 6 months after death) PLUS the amount she spent on the improvements. Not only will Eva get to enjoy an updated bathroom and kitchen, she'll avoid some capital gains tax when she sells the property (assuming she sells it at a profit exceeding $250,000).

Volunteer Work

Eva has a big heart to do all that volunteering. Hopefully she gets a huge sense of satisfaction out of it, because her tax benefits are dismal. While you can deduct the value of property and cash that you give to a charity, you can't deduct the value of your personal services. However, she may be able to deduct the cost of using her car while volunteering, and any other out-of-pocket expenses she may incur. If she keeps very good and detailed records, she could ask the charity to reimburse her 56 cents per mile for driving around for them. If they don't reimburse her, she can deduct that mileage from her income. Note that this will only work if the charity is a "qualified" charity operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. If the charity engages in lobbying, she won't get a deduction either (but in real life the lobbying aspect is very loose and not really enforced by the IRS).