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Notable Legislative Changes from 2012 Onward.

The most significant statutory change since the publication of the 16th Edition was the enactment of the American Taxpayer Relief Act of 2012 (ATRA 2012) on January 2, 2013. ATRA 2012 incorporated numerous important changes, several of which are relevant to the introductory tax class. Briefly summarized below are the changes to the individual income tax rate structure, maximum statutory rates for net capital gain and qualified dividends, phase-out of the personal exemption, the overall limitation on itemized deductions, and the alternative minimum tax.

Tax Rate Changes. The individual income tax rate reductions originally enacted as part of the 2001 and 2003 Bush-era tax legislation were scheduled to expire on December 31, 2012. ATRA 2012 permanently extended the Bush tax rate reductions (i.e., the 10%-35% rates) for all income levels below \$400,000 (unmarried) and \$450,000 (married filing jointly), but reintroduced the 39.6 percent rate for income above those thresholds. These figures applied for taxable year 2013. As with all the breakpoints between rate brackets, the \$400,000/\$450,000 breakpoints are indexed for inflation. For 2016, the breakpoints for the top 39.6% rate for unmarried and married filing jointly taxpayers are \$415,050 and \$466,950, respectively. In addition to the rates applicable to ordinary income, ATRA 2012 increased the maximum tax rate for “net capital gain” (including qualified dividends). Under the 2001 and 2003 legislation, the maximum tax rate for net capital gains was 15 percent. Under the new ATRA 2012 legislation, taxpayers subject to an ordinary income tax rate of 39.6 percent face a maximum tax rate for net capital gains of 20 percent.

Pease and PEP. ATRA 2012 reintroduced provisions of section 68 (the overall limitation on itemized deductions) and section 151(d)(3) (relating to the phase-out of personal exemptions). Under section 68, commonly referred to as the “Pease” limitation, for an individual whose adjusted gross income exceeds the “applicable amount,” the amount of all itemized deductions (other than those for medical expenses, investment interest, and casualty or theft losses) is reduced by the lesser of (1) 3 percent of the excess of adjusted gross income over the applicable amount, or (2) 80 percent of the amount of all itemized deductions other than the three mentioned above. For 2016, the “applicable amount” is \$311,300 for joint returns, and \$259,400 for unmarried individuals. Under section 151(d)(3), deductions for personal exemptions are reduced – eventually to zero – as adjusted gross income rises above the same “applicable amounts” as those applying under section 68. Specifically, one’s otherwise allowable personal exemptions are reduced by 2 percentage points for each \$2,500 (or fraction thereof) by which the taxpayer’s adjusted gross income exceeds the relevant applicable amount.

Alternative Minimum Tax. A common feature of the tax legislative process in recent years has been the annual battle over enacting the so-called “AMT patch” (i.e., the AMT exemption amount under section 55(d)) to shield millions of taxpayers from AMT liability. ATRA 2012 incorporated a permanent inflation-indexed patch. For tax year 2016, these amounts are \$53,900 for unmarried individuals and \$83,800 for married taxpayers filing jointly. ATRA 2012 also allowed nonrefundable personal credits against both regular and AMT tax liability.

Other Miscellaneous Provisions. In addition to the foregoing, ATRA 2012 incorporated various other miscellaneous changes worth noting, including (1) a permanent extension of the \$1,000 child tax credit under section 24, (2) permanent extension of certain enhancements to the child and dependent care tax credit of section 21, (3) a five-year extension of the American Opportunity Tax Credit of section 25A(i). With regard to business provisions, ATRA 2012 extended through 2013 certain tax incentives, including 50 percent bonus depreciation under section 168(k), enhancements to section 179 expensing, the section 41 research tax credit, and the Work Opportunity Tax Credit of section 51.

Certain of these provisions (bonus depreciation, work opportunity credit) were further extended through 2019 by the Protecting Americans from Tax Hikes (PATH) Act of 2015, while others were permanently extended (research tax credit, enhancements to section 179 expensing).

Supreme Court Rulings on Same-Sex Marriage.

United States v. Windsor and Obergefell v. Hodges. On June 26, 2013, the U.S. Supreme Court issued its opinion in the case of *United States v. Windsor*, 570 U.S. ____ (2013) concerning the constitutionality of Section 3 of the Defense of Marriage Act (DOMA). Precisely two years later, on June 26, 2015, the Court decided *Obergefell v. Hodges*, 576 U.S. ____ (2015). The combined effect of these two cases is that same-sex marriage must now be recognized as a legal marriage to the same extent as opposite-sex marriage both for purposes of federal law as well as a matter of state law.

Marital status is relevant to numerous income tax provisions throughout the tax code. Most obviously, these holdings are relevant for purposes of determining the filing status (married filing jointly, married filing separate) of same-sex married couples. Section 1. All married couples, whether same sex or opposite sex, will now face the same structure of possible marriage “penalties” and “bonuses” applicable to all married couples. Other implicated provisions include (but are certainly not limited to) section 32 (the earned income tax credit), sections 71 and 215 (concerning the receipt and payment of alimony), section 121 (exclusion of gain from the sale of a principal residence), various provisions concerning excludible employer-provided benefits (e.g., sections 105, 106, 119, 132), various “floors” (e.g., sections 67, 165(c)(3), 213) and “ceilings” (e.g., section 68) that make reference to the filing unit’s AGI level, section 1041 (regarding the transfer of property incident to divorce), section 6015 (innocent spouse relief), and 1211(a) (capital loss limitations). Again, this is just a small sample of provisions with effects that vary depending on the taxpayer’s marital status.

In late August 2013, the IRS issued Revenue Ruling 2013-17, addressing numerous federal tax aspects of the *Windsor* decision. The IRS also provided two documents detailing answers to several frequently asked questions for (1) individuals of the same sex who are married under state law, and (2) registered domestic partners and individuals in civil unions. Following *Obergefell*, on November 9, 2015, the Internal Revenue Service issued a Notice of Proposed Rulemaking providing additional guidance regarding the definition of terms relating to marital status. (See IRB 2015-45, REG-148998; available at https://www.irs.gov/irb/2015-45_IRB/ar09.html).

Final Regulations under Section 104(a)(2).

In 2012 the IRS issued final regulations under section 104(a)(2) of the Internal Revenue Code concerning the taxation of damages received on account of personal physical injury or physical sickness. The regulations reflect the statutory amendments made by the Small Business Job Protection Act of 1996 (i.e., no exclusion for punitive damages or damages received on account of non-physical injury/sickness). The final regulations clarify that a taxpayer may exclude damages received on account of emotional distress that is attributable to a physical injury or physical sickness. They also eliminate the requirement that the personal injuries or sickness be “based upon tort or tort-type rights.” Under the new final regulations, section 1.104-1(c)(1) and (2) read as follows:

(c) *Damages received on account of personal physical injuries or physical sickness*—(1) In general. Section 104(a)(2) excludes from gross income the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical inju-

ries or physical sickness. Emotional distress is not considered a physical injury or physical sickness. However, damages for emotional distress attributable to a physical injury or physical sickness are excluded from income under section 104(a)(2). Section 104(a)(2) also excludes damages not in excess of the amount paid for medical care (described in section 213(d)(1)(A) or (B)) for emotional distress. For purposes of this paragraph (c), the term damages means an amount received (other than workers' compensation) through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution.

(2) *Cause of action and remedies.* The section 104(a)(2) exclusion may apply to damages recovered for a personal physical injury or physical sickness under a statute, even if that statute does not provide for a broad range of remedies. The injury need not be defined as a tort under state or common law.

For the full document, see T.D. 9573, located at page 498 of IRB 2012-12, which can be found online at <http://www.irs.gov/pub/irs-irbs/irb12-12.pdf>.

Final Repair Regulations under Sections 162/263.

In September 2013 the IRS issued final regulations specifying when taxpayers must capitalize expenses or claim a current deduction. The regulations provide detailed rules governing expenses for materials and supplies (Reg. 1.162-3), repairs and maintenance (Reg. 1.162-4), capital expenditures (Reg. 1.263(a)-1), and amounts paid for the acquisition (1.263(a)-2) and improvement (1.263(a)-3) of tangible property. The complete regulations, including a description of changes from the proposed regs, are set forth in T.D. 9636 (here: <http://www.gpo.gov/fdsys/pkg/FR-2013-09-19/pdf/2013-21756.pdf>) and summarized by CCH (here: <http://tax.cchgroup.com/downloads/files/pdfs/legislation/repair-capitalization-regulations.pdf>).