Note: No new Update is available for 2023. I've marked this 2022 Update to show some later developments. – J.B.

Federal Income Taxation, Schmalbeck, Zelenak, Lawsky, & Oei
September 2022 Update to Casebook

This September 2022 Update highlights major tax law changes that have occurred since the release of the 5th Edition. Instructors may provide a copy of this Update to students for their use.

CHAPTER 1:

p. 2-13 — Introductory Problem

These pages include a Problem involving computation of the taxpayers' gross income, adjusted gross income, and taxable income, followed by a discussion and solution. The problem and the calculation in the casebook concerns a 2018 federal tax return and reflects 2018 law. Subsequent legislative changes have changed the calculation for later tax years in ways that raise interesting issues. The following changes are of particular relevance:

p. 7 — Taxable Income Computation; Charitable Contribution Deduction for Non-Itemizers

The March 2020 Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136 ("2020 CARES Act") provided a charitable contribution deduction of up to $300 for non-itemizers for the 2020 tax year, and the December 2020 Consolidated Appropriations Act of 2021, Pub. L. No. 116-260 Section 114 Div. EE ("2021 CAA"), modified and extended this deduction for non-itemizers to 2021. The combined effect of these pieces of legislation is that single and head of household filers who do not itemize deductions can deduct up to $300 of charitable contributions in each of 2020 and 2021. Married taxpayers who file jointly and do not itemize deductions can deduct $300 in 2020 and $600 in 2021. (In its tax return instructions, the IRS interpreted the 2020 CARES Act as giving joint return filers a $300, not a $600, deduction for 2020. In the 2021 CAA, Congress explicitly stated that the amount of the 2021 deduction for joint filers is $600.) For 2022, this charitable deduction for non-itemizers does not apply.

Nor does it for 2023.

p. 12 — IRC § 21 Child Care Credit

The taxpayers in the problem are married, have two young children, and spent $9,000 on childcare. The discussion starting in the middle of page 12 walks through the computation of the IRC § 21 Child and Dependent Care Tax Credit as in effect for 2018. For 2021, the following changes would apply:

The American Rescue Plan Act of 2021 ("2021 ARPA"), enacted in March 2021, provides that for tax year 2021, the dollar amount of the child care credit will be increased dramatically and the credit will be refundable. Specifically, the "dollar limitation" on the employment-related expenses creditable will be increased to $16,000 if there are two or more "qualifying individuals" (children) (ARPA § 9631). Thus, for 2021, the Smiths' $9,000 of child care expenses are no longer capped at $8,000. Moreover, for 2021, the "applicable percentage" of such expenses creditable will be raised to 50% (from 35%), and the phaseout down to 20% in IRC § 21(a)(2) will only apply for taxpayers whose AGI exceeds $125,000. Thus, for 2021,

because the Smiths' AGI of $133,000 exceeds $125,000 by $8,000, their "applicable percentage" is reduced by 4 percentage points to 46%. The Smiths' child care credit computation would be 46% x $9,000 = $4,140. Since the credit is refundable, the Smiths would receive the full credit regardless of whether they owed any tax liability.

For tax year 2022, absent further legislative changes, the 2021 ARPA changes described above no longer apply, and the analysis in the casebook would apply (i.e., the Smiths can reduce their tentative tax liability under § 1(a) by $1,200. (The dollar amounts of the § 21 credit are not annually adjusted for inflation.)

The same is true for 2023.

p. 13 — IRC § 24 Child Tax Credit

The 2021 ARPA expanded the IRC § 24 child tax credit for the 2021 tax year, increasing the credit amount per child from $2,000 to $3,000 ($3,600 for a qualifying child under age 6), and making the credit fully refundable. Thus, in the introductory problem, the Smiths would be allowed a total child tax credit of $7,200 (ARPA § 9611). This increased credit amount is reduced to the extent the taxpayer's modified adjusted gross income (generally, gross income adding back certain items) exceeds $150,000 in the case of a joint return. Because the Smiths have AGI of $133,000, this limitation would not apply.

Broadly speaking, the expansion of the child care credit and the child tax credit in the wake of the COVID-19 pandemic reflects a Congressional interest in expanding anti-poverty tools, supporting working families with children, and ameliorating income inequality.

For tax year 2022, absent further legislative changes, the 2021 ARPA changes described above no longer apply, and the computation in the casebook applies (i.e., the Smith's child tax credit will be $4,000). § 24(h). The amounts are not subject to inflation adjustments.

The same is true for 2023.

<u>Effect of the Above Changes on 2021 Tax Computation</u>

The changes discussed above change the calculation of the Smiths' tax liability to a significant extent. So, for tax year 2021:

(1) *Gross Income and AGI*. Assuming their income and expense items stay the same for 2021, the Smiths have gross income of $135,000. After deducting the $2,000 IRA contribution, their AGI is $133,000.

(2) *Taxable Income*. For 2021, they can deduct a $600 charitable contribution. IRC § 170(p). Note that because this new deduction is not an above-the-line deduction, it does not affect the AGI calculation (see Update to p. 370-372, below). Subtracting this $600 deduction and the $25,100 standard deduction from AGI gives $107,300 taxable income.

(3) *Tax Liability before Credits*. Applying the 2021 tax rate schedules for joint return filers, the Smiths will have a total tax liability of $14,753. This consists of $14,003 (applying the 2021

ordinary income rate schedule, which puts them in the 22% marginal rate bracket), plus $750 ($5,000 long-term capital gain taxed at the 15% capital gains rate).

(4) *Tax Liability after Credits*. The Smiths are entitled to three types of refundable credits for 2021, totaling $16,940:

- Recovery rebate of $5,600 ($2,800 for married couple filing jointly plus $1,400 each for two qualifying dependents) (for further discussion of the recovery rebates, see Update to p. 812-14, below);
- Child tax credit of $7,200;
- Child care credit of $4,140.

After application of these credits, the Smiths will be left with a tax of *negative* $2,187, i.e., $14,753 tax liability minus $16,940 refundable credits. (Assuming that they received the recovery rebates and part of the child tax credit in advance, they would not receive a check for $2,187 from the IRS after filing their return.) Thus, once the recovery rebate and the expanded and refundable credits are taken into account, the Smiths' tax liability is eliminated for 2021, a striking change from their 2018 tax liability of $10,309.

Annotated for 2023.

2022 tax computation:

The Smiths' income remains $135,000. [Same for 2023.]

Their adjusted gross income remains $133,000. [Same for 2023.]

The Smiths' taxable income will be $107,100 (i.e., $133,000 minus $25,900, the inflation-adjusted standard deduction for 2022). Rev. Proc. 2021-45. They will take the standard deduction because it exceeds their itemized deductions. [For 2023, $105,300 (i.e., $133,000 minus $27,700, the inflation-adjusted standard deduction for 2023). Rev. Proc. 2022-38.]

The Smiths' tentative tax liability before credits will be $14,796 (i.e., $9,615 plus (22% x (107,100-$83,550)). Rev. Proc. 2021-45. [For 2023, $13,781 (i.e., $10,294 plus (22% × ($105,300 – $89,450)). Rev. Proc. 2022-38.]

From here, we subtract the $350 capital gains tax credit under §1(h), the §21 child care credit ($1,200), and the §24 child tax credit ($4,000), leaving $9,246 in tax. [For 2023, $8,231.]

p. 34 — Cliff Effect and the Earned Income Tax Credit

The last paragraph on p. 33, which carries over to p. 34, discusses a cliff effect in the EITC's design. The second sentence on p. 34 discusses the IRC § 32(i) cliff. The 2021 ARPA has permanently increased this IRC § 32(i) cliff from $2,200 (adjusted annually for inflation) to $10,000 for 2021 and later tax years (adjusted annually for inflation). ARPA § 9624. [Still true.]

p. 36 — Phaseouts and the Child Tax Credit

The 2021 ARPA has increased the amount of the child tax credit to $3,000 per qualifying child for 2021 ($3,600 for a child below 6 years old). IRC § 24(i). The increased credit amount is subject to phaseout above certain income levels ($75,000 for a single taxpayer, $150,000 for married taxpayers filing jointly). IRC § 24(i)(4). The credit for qualifying children has been made fully refundable for 2021. IRC § 24(i)(1).

The 2021 enhancements of the child tax credit have expired for tax years beginning after December 31, 2021.

Still true.

These temporary modifications have all expired.

p. 37 — Payroll Taxes and the Net Investment Income Tax

Legislation in 2020 and 2021 made temporary modifications to the payroll tax rules. For example, the 2020 CARES Act allowed qualifying employers (generally, employers who have not enjoyed Paycheck Protection Program loan forgiveness under the CARES Act) to defer payment of the employer portions of Social Security and RRTA taxes otherwise due from March 27 through December 31, 2020 without interest or penalties. CARES Act § 2302. 50% of the deferred amount is due by December 31, 2021 and the remainder is due by December 31, 2022.

In addition, for wages paid from March 13 to December 31, 2020, the 2020 CARES Act provided eligible employers (generally, employers whose business has been affected by COVID-19) a payroll tax credit equal to 50% of up to $10,000 of qualified wages paid to an employee during a quarter. Notice 2021-20; CARES Act § 2301. This effectively means that the credit is capped at a maximum of $5,000 per employee per quarter. The 2021 CAA extended this credit for the first and second quarters of 2021, and the 2021 ARPA modified the credit (including by increasing the maximum quarterly amount per employee in 2021 to $7,000) and extended the credit to the third and fourth quarters of 2021.

In general, these modifications were enacted to further the policy goal of providing support for businesses adversely affected by the COVID-19 pandemic and encouraging businesses to retain employees on payroll.

CHAPTER 2:

p. 78 — Additional Example Regarding Includability of State Income Tax Refund

Insert the following before the last paragraph on p. 78:

A Revenue Ruling issued in 2019 explored additional complications surrounding the interplay of the $10,000 cap on SALT deductions and the rules on taxability of state income tax refunds. Consider this example, based on one of the scenarios outlined in that ruling (Rev. Rul. 2019-11, Situation 4):

Example 2.4A. In 2018, Jane paid state and local taxes of $10,250. She also had $2,500 of other itemized deductions in that year. Because she could only deduct $10,000 of state and local taxes (see Chapter 4.C., at page 403), she claimed total itemized deductions of $12,500. She could instead have claimed the standard deduction of $12,000 available to single taxpayers in 2018. In 2019, Jane received a state income tax refund of $1,000. How much, if any, of this refund must Jane include in income for 2019?

Because Jane received only $500 of benefit—the excess of her itemized deductions over the standard deduction that she could have claimed—only that part of the refund must be reported as income in 2019.

p. 115, Note 1 — 50% Limitation on Expense for Food or Beverages

IRC § 274(n)(2)(D), added to the Code by the 2021 CAA, provides that the 50% limitation does not apply to expenses for "food and beverages provided by a restaurant" paid or incurred in 2021 or 2022. For those years, such restaurant meal expenses will be eligible for a 100% deduction. (For further discussion, see Update to p. 542, below).

This provision does not apply to 2023 and later years.

p. 119 — One-Earner Couples and the Child Care Credit

The concerns described in the paragraph immediately before Problem 2.5 would presumably remain even after the 2021 changes to the child care credit (See Update to p. 12, above).

p. 127-128 — IRC § 36B Premium Tax Credit

The 2021 ARPA made some temporary changes to the IRC § 36B premium tax credit. The Act temporarily increased the credit amount for the 2021 and 2022 years. Thus, for taxpayers with income at 400% of the poverty level, the credit for those years will cover the amount by which the cost of basic health insurance exceeds 8.5%. The Act also temporarily expanded eligibility for the credit, for example, with respect to individuals receiving unemployment compensation during 2021 and (in certain cases) individuals earning above 400% of the poverty line for the 2020 and 2021 years. The Inflation Reduction Act of 2022, Pub. L. No. 117-169 (the "2022

Inflation Reduction Act" or "2022 IRA"), signed into law on August 16, 2022, has extended this expanded premium tax credit to cover tax years beginning before January 1, 2026. 2022 Inflation Reduction Act, § 12001.

p. 137 — Note 3 on Tax Benefits for College and University Tuition

Legislation in 2020 and 2021 now provides that an employer's payment of principal and interest on a qualified educational loan (as defined in IRC § 221(d)(1)) incurred by the employee is a tax free benefit included in the $5,250 maximum annual exclusion in IRC § 127(a)(2). This change is in effect for payments made from March 27, 2020 through the 2025 calendar year. In other words, for this period, $5,250 is the combined limitation for qualifying loan repayments by employers (whether paid directly to the employee or to a lender) and tuition paid by the employer under an "educational assistance program." 2020 CARES Act § 2206; 2021 CAA§ 120.

p. 138 — Higher Education Tax Credits; Repeal of IRC § 222

The following changes apply to the two higher education credits and the IRC § 222 deduction discussed in the first and second full paragraph on p. 138:

The Hope Scholarship Credit (IRC § 25A(b)) has been renamed the American Opportunity Credit.

The 2021 CAA modified the phaseout rule for higher income taxpayers for the Lifetime Learning Credit (IRC § 25A(c)), aligning it with the more generous phaseout rule for the American Opportunity Credit. IRC § 25(d).

In addition, also in the 2021 CAA, Congress finally repealed IRC § 222 (the deduction for tuition expenses), effective for 2021 and later tax years.

These special rules do not apply to net operating losses arising after 2020.

p. 142-43 — CARES Act Changes to Net Operating Loss Rules

Section 2303 of the 2020 CARES Act temporarily modified the NOL rules as follows:

First, the CARES Act temporarily repealed the 80% of net income limitation, allowing taxpayers a NOL deduction equal to 100% of taxable income for tax years before the 2021 tax year. For the 2021 and later tax years, taxpayers are allowed a 100% deduction of NOLs arising before 2018 plus post-2017 NOLs to the extent they do not exceed 80% of taxable income (computed after taking pre-2018 NOLs into account).

Second, the CARES Act also amends the NOL carryover rules. The Act allows most taxpayers to carry back NOLs arising in 2018, 2019, and 2020 to the 5 tax years preceding the NOL. This is a change from the prior rule (enacted in the 2017 TCJA, and subject to certain exceptions), which

provided that NOLs can be carried forward to future tax years but cannot be carried back to preceding years. Taxpayers may, however, elect to waive this 5-year carryback and only carry the NOLs forward to future tax years. For tax years starting in 2021, the carryback rule does not apply. NOLs arising in these years can therefore no longer be carried back.

Broadly speaking, these changes can be characterized as broadening or increasing NOL availability, with a goal of financially supporting businesses in the COVID-19 pandemic.

p. 147 — Note 8 on Qualified Principal Residence Indebtedness

The IRC § 108(a)(1)(E) exclusion, discussed in Note 8 of the casebook, was extended through December 31, 2020 and made retroactive to 2018 and 2019 by the 2020 Consolidated Appropriations Act (Pub. L. No. 116-94, Dec, 20, 2019, § 101(a) Div, Q). That provision was subsequently extended through December 31, 2026 by the 2021 CAA. However, for 2021 and later years, the ceilings have been reduced to $375,000 and $750,000 (down from the previous $1,000,000/$2,000,000 ceiling discussed in the casebook).

p. 148 — New Note 9 on Forgiveness of Paycheck Protection Program (PPP) Loans

Add the following new Note 9 to the bottom on p. 148:

9. *Forgiveness of COVID-19 Paycheck Protection Program (PPP) Loans*. Another more recent example of a special rule regarding certain debt cancellations is Congress's treatment of PPP loans in the 2020 CARES Act. These PPP loans qualify for forgiveness if used for certain payroll, mortgage interest expense, utilities, rent, and other costs. Loan recipients can apply for forgiveness by filling out an application and providing required documentation.

Should such PPP loan forgiveness be taxable as cancellation of indebtedness income? Arguably, such an income inclusion would cut against the policy goals of the PPP loan and forgiveness program, which are generally concerned with helping small businesses financially during the COVID-19 crisis. Congress's answer was "no," and it specified in CARES Act § 1106(i) that any PPP loans forgiven under the CARES Act will not be included in gross income.

Moreover, Congress further clarified in § 276 of the 2021 CAA that expenses paid with forgiven PPP loans are deductible, and that borrowers do not have to reduce any tax attributes and will not be denied any basis increases despite the exclusion from gross income of such loan forgiveness.

CHAPTER 4:

p. 370-72 — Standard Deduction vs. Itemized Deductions; Discussion of Charitable Contribution Deduction

The 2020 CARES Act and the 2021 CAA made some temporary changes to the deductibility of charitable contributions for taxpayers taking the standard deduction. As a result, taxpayers who do not itemize deductions, whether on a joint or single return, are eligible for a deduction of up to $300 for qualified cash charitable contributions for the 2020 tax year. For the 2021 tax year, that amount has been increased to $600 for joint filers, but remains at $300 for single taxpayers. For the 2021 tax year, that amount has been increased to $600 for joint filers. IRC §§ 62(a)(22); 170(p); 2021 CAA § 212. Notably, this new deduction is not an above-the-line deduction that is reflected in adjusted gross income. Like the IRC § 199A deduction introduced in the 2017 TCJA, it is neither an above- nor a below-the-line deduction. IRC § 63(b)(4). For 2022, this charitable deduction for non-itemizers does not apply.

Nor does it apply for 2023. The IRC § 199A is still very much in effect in 2023, however.

These special rules have expired.

p. 382-84 — Limitation on Charitable Contribution Deductions for Individual Taxpayers and Corporate Taxpayers

By virtue of the 2020 CARES Act and the 2021 CAA, the limitation on an individual's charitable contribution deduction has been suspended for cash contributions in the 2020 and 2021 tax years. The usual rule, described on pp. 382-83 of the casebook, is that charitable contributions are generally limited to 50% of the individual taxpayer's contribution base, with a 60% limit for cash contributions. Under the ~~new~~ legislation, cash contributions are no longer limited for the 2020 and 2021 years, provided the taxpayer elects to have the rule apply. CARES Act § 2205; CAA § 213. The 50% limit continues to apply for non-cash contributions. The same legislation increased the charitable contribution limitation for cash charitable contributions made by corporate taxpayers (discussed on p. 384) from 10% to 25% for the 2020 and 2021 tax years.

These special rules have expired.

p. 395 — Business Debt; CARES Act Changes to IRC §163(j)

Section 2306 of the 2020 CARES Act made some changes to the IRC §163(j) limitation on deductibility of business interest. Most pertinently, the CARES Act retroactively increased the IRC §163(j) limitation on interest expense deductibility from 30% to 50% of adjusted taxable income for tax years beginning in 2019 and 2020. (A special rule applies to partnerships for 2019.) Section 2306 also allows taxpayers to elect to calculate the IRC §163(j) interest limitation for the 2020 tax year applying their 2019 "adjusted taxable income."

p. 421 — Medical Expenses Deduction Floor

Insert after the discussion in Chapter 4.E.1:

The medical expenses deduction floor has been made permanent at 7.5% by the 2021 CAA.

p. 438 — Further Discussion of Personal Credits

Congress renewed a number of energy tax credits in the 2021 CAA. Subsequently, in the 2022 Inflation Reduction Act, Congress heavily revised some of the tax credits available to taxpayers and introduced new ones. A key feature of the 2022 IRA was its inclusion of important provisions meant to address the impacts of climate change. The general approach taken in the 2022 IRA was to offer tax credits to consumers and businesses to encourage the production, purchase, and use of "clean energy" products and property that produce no or little greenhouse gases. The overall approach of the 2022 IRA credits can be characterized as offering a "carrot" or incentive to taxpayers, as opposed to using "sticks" (for example, by imposing a carbon tax or penalties for emissions).
Some of 2022 IRA credits available to individual taxpayers deserve particular attention for their potential effects on the tax liabilities of many taxpayers and their interesting design features.

Revised and Renamed §30D (Clean Vehicle Credit). The 2022 IRA significantly revised and also renamed §30D the "Clean Vehicle Credit." (Prior to revision, the credit was named the "[n]ew qualified plug-in electric drive motor vehicles" credit.) The changes are effective for vehicles placed in service after December 31, 2022 and before January 1, 2033.

As revised by the 2022 IRA, §30D lets taxpayers claim a credit for credit-eligible "clean vehicles" meeting the statutory requirements. The definition of credit-eligible "clean vehicles" is largely the same as under prior law, except that the minimum battery capacity has been increased to at least 7 kilowatt hours (up from 4), the seller of the vehicle must furnish a report to the buyer and the IRS, and the final assembly of the vehicle must take place in North America. "Clean vehicles" also includes "qualified fuel cell motor vehicles," as defined in §30B(b)(3), if the vehicle meets the report requirement and final assembly requirement discussed above. If the vehicle satisfies both a "critical minerals" requirement and a "battery components" requirement, the credit amount for the vehicle is $7,500. If the vehicle only satisfies one of these two requirements, then the credit amount is $3,750.

Revised §30D contains limitations based on the taxpayer's modified adjusted gross income (modified AGI) and on the vehicle's manufacturer's suggested retail price (MSRP). A taxpayer is not eligible for the credit if the taxpayer's modified AGI for either the year of purchase or the preceding year exceeds a specified threshold amount, set at $300,000 for a joint return or surviving spouse, $225,000 for a head of household, and $150,000 for any other taxpayer. §30D(f)(10). No credit is allowed for a vehicle if the MSRP exceeds $80,000 (for a van, SUV, or pickup) or $55,000 (for any other vehicle). §30D(f)(11). Both the modified AGI and the MSRP limitations are examples of dollar limitations designed as cliff effects rather than phaseouts, which is in sharp contrast with most other income-based limitations on tax benefits. So, for example, an otherwise qualified taxpayer with modified AGI of exactly $150,000 in each of the two relevant years is entitled to a credit of $7,500, but if the taxpayer's income had been $1 higher in either year, the taxpayer would have been entitled to no credit. Or, if the MSRP for an otherwise qualifying SUV is $80,001, the entire clean vehicle credit is disallowed for that SUV. None of the statutory dollar amounts in revised § 30D are indexed for inflation.

Another notable feature of revised §30D is that, beginning in 2024, a taxpayer purchasing a qualified vehicle will have the option of transferring the right to the credit to the dealer in exchange for a payment equal to the amount of the credit from the dealer to the purchaser (either in cash or, more likely, treatment as a partial payment for or down payment on the vehicle). §30D(g). The dealer will then be entitled to receive advance payments from the Treasury on account of transferred credits. §30D(g)(7). Such dealer payments are not includible in the gross income of the purchasing taxpayer, and are not deductible by the dealer. IRC § 30D(g)(5). The idea behind this is that taxpayer purchasing decisions will be more responsive to a tax benefit available immediately (functioning as a purchase price reduction) than to a tax benefit received months later following the filing of the taxpayer's tax return for the year of purchase.

New §25E Credit for Previously-owned Clean Vehicles. The 2022 IRA also added new §25E, a credit for the purchase of used "clean vehicles." The credit is available for qualifying purchases made after December 31, 2022 and before January 1, 2033. §25E(g). The definition of qualifying "previously-owned clean vehicles" builds on and modifies the definition of clean vehicles for purposes of the new clean vehicle credit. §§ 25E(c)(1), §30D(d). Among other definitional modifications, the vehicle's model year must be at least two years earlier than the calendar year in which the taxpayer buys the vehicle, the vehicle's original use must have been by a person other than the taxpayer, the taxpayer's purchase must be from a dealer and must be the first transfer of the vehicle since the date of enactment of § 25E to a qualified buyer other than the original user of the vehicle, and the purchase price must not be more than $25,000. §25E(c)(2). Assuming these requirements are met, the allowable credit amount is the lesser of $4,000 or 30 percent of the vehicle's sale price. §25E(a).

Like §30D, §25E also contains income limitations based on the taxpayer's modified AGI and is designed with a similar cliff effect, rather than a phaseout. A taxpayer is not eligible for the credit if the taxpayer's modified AGI for either the year of purchase or the preceding year exceeds a specified threshold amount, set at $150,000 for a joint return or surviving spouse, $112,500 for a head of household, and $75,000 for any other taxpayer. §25E(b)(2). So, for example, an otherwise qualified taxpayer with modified AGI of exactly $75,000 in each of the two relevant years may be entitled to a credit of as much as $4,000, but if the taxpayer's income had been $1 higher in either year, the taxpayer would be entitled to no credit. Beginning in 2024, rules similar to those of §30D(g) will allow a purchasing taxpayer to transfer the right to the credit to the dealer in exchange for a corresponding price reduction.

§25C Energy Efficient Home Improvement Credit. In addition to the §30D and §25E clean vehicle credits, the 2022 IRA also revised and extended the personal credit for certain nonbusiness energy property expenditures under §25C, renaming it the "Energy Efficient Home Improvement Credit." For property placed in service after December 31, 2021 and before January 1, 2033, the §25C credit amount is 30% of the sum of amount paid or incurred by the taxpayer for "qualified energy efficiency improvements," "residential energy property expenditures," and "home energy audits" (the last being a new category of credit-eligible expenses created by the 2022 legislation). §25C(a). This is an increase from prior law. The total credit allowed in any given year is generally limited to $1,200 per taxpayer per year, but lower annual limits apply to credits for particular types of expenditures ($600 for any item of qualified

energy property, $600 for all exterior windows and skylights, $250 for any exterior door and $500 in the aggregate for exterior doors, and $150 for HEAs). There is, however, an exception permitting a credit of up to $2,000 for certain heat pump and heat pump water heaters, and certain biomass stoves and boilers. §25C(b)(5).

§25D Residential Clean Energy Credit. The 2022 IRA also extended the §25D credit for residential clean energy property expenditures through 2035 and modified it to make it available for qualified battery storage technology expenditures. The §25D credit has been renamed the "residential clean energy credit." The new provisions generally apply to expenditures made after December 31, 2021, except that the credit for qualified battery storage technology expenditures applies to expenditures made after December 31, 2022.

p. 478 — Casualty Losses; Federally Proclaimed Disasters

Add to Note 5 (on federally proclaimed disasters):

On March 13, 2020, then-President Trump declared the COVID-19 pandemic a federal disaster. This emergency declaration—made under the Robert T. Stafford Disaster Relief Act, Pub. L. No. 100-707—made IRC § 165(i) applicable to COVID-19 related losses. As a result, taxpayers suffering a qualifying 2020 loss due to COVID-19 may accelerate these losses to 2019 (for example, by filing an amended return).

Of course, the application of IRC § 165(i) to the COVID-19 pandemic raises a number of interpretation issues, including whether such losses are temporary, when the disaster "occurred," and whether physical damage is required in order to claim a loss.

This temporary amendment has expired.

CHAPTER 5:

p. 542 — Note 3(3): CARES Act Temporary 100% Deduction for Restaurant Meals

The 2020 CARES Act temporarily amended the IRC § 274(n) limitation by allowing a 100% business meals deduction for food and beverages provided by a restaurant paid or incurred in 2021 and 2022. This lifting of the 50% limitation is presumably to support the restaurant industry during the pandemic by encouraging businesses to buy business meals at restaurants.

Under new regulations, meals are not regarded as non-deductible entertainment (subject to IRC § 274(a)) unless they are provided during an entertainment activity, such as a baseball game. Treas. Reg. § 1.274-11(b)(1)(ii). Thus, meals provided to clients or customers are fully deductible for the 2021 and 2022 tax years, and will revert to 50% deductibility thereafter (unless IRC § 274 is amended further).

p. 580 — Note 4: IRC § 162(m)

As amended in 2021, and effective as of 2027, IRC § 162(m)(3)(C) expands the definition of "covered employees" (i.e., employees who are subject to the IRC § 162(m) deduction disallowance) to include the taxpayer's five most highly compensated employees *in addition to* employees already included under IRC § 162(m). In other words, in addition to the CEO, CFO, and three highest paid employees whose salaries are required to be reported under the Securities Exchange Act of 1934, the salaries of the next five highest paid employees will also be subject to the IRC § 162(m) exclusion, effective as of 2027.

CHAPTER 8:

p. 706 — IRC § 461(l) Excess Business Loss Disallowance; CARES Act Changes

The 2020 CARES Act removes the IRC § 461(l) disallowance of "excess business losses" for tax years beginning in 2018, 2019, and 2020, which basically allows taxpayers to deduct business losses in excess of the statute's income threshold. Thus, Example 8.2 on p. 707 would not apply for tax years beginning in 2018, 2019, and 2020. Taxpayers who filed a 2018 or 2019 tax return with the IRC § 461(l) limitation may file an amended return.

The Inflation Reduction Act of 2022 has extended the disallowance of excess business losses in §461(l) for any tax year beginning before January 1, 2029. Therefore, the combined effect of the 2020 CARES Act changes and the 2022 Inflation Reduction Act changes is that excess business losses of noncorporate taxpayers are disallowed from 2021 through 2028.

CHAPTER 9:

p. 740 — IRC § 21 Child Care Credit

As discussed above, 2021 ARPA has made temporary modifications to the IRC § 21 child care credit. The new legislation provides that for the 2021 tax year, the dollar limitations of the child care credit will be increased dramatically and the credit will be phased out at much higher income levels. The credit will also be refundable for qualifying taxpayers (generally, taxpayers meeting certain U.S. residency requirements).

Specifically, expenses eligible for the credit will be capped at $8,000 for a taxpayer with one qualifying individual (increased from $3,000) and at $16,000 for a taxpayer with two or more qualifying individuals (increased from $6,000). (IRC § 21(g); ARPA § 9631). A taxpayer with AGI of $125,000 or less is eligible for a credit of 50% of credit-eligible expenses. This 50% credit rate is reduced by one percentage point for each $2,000 (or fraction thereof) by which AGI exceeds $125,000, but the credit is not reduced below 20%, except in the case of the new phaseout rules for high-income taxpayers, described below. Thus, the credit hits the 20% floor when AGI exceeds $183,000. The credit rate remains at 20% for taxpayers with AGI of $183,001 up to $400,000. But for taxpayers with AGI above $400,000, it again becomes subject to phaseout, and is reduced by one percentage point for each $2,000 (or fraction thereof) by which AGI exceeds $400,000. This means that taxpayers with AGI above $438,000 will not receive any child care credit. This new high-income taxpayer phaseout reflects a Congressional decision not to subsidize high-income taxpayers for their child care expenses.

The temporary expansion has expired.

The child care credit expansion effectuated by the ARPA is temporary, but the Biden administration has expressed interest in making it permanent. Whether temporary or permanent, the expansion obviously affects the discussion at pp. 740-41. The expansion increases the value of the subsidy, and therefore increases the value of the child care credit as compared to a deduction for child care expenses. The credit expansion may also reflect increased recognition in the current Congress of childcare as a legitimate business expense. Moreover, by retaining the original phaseout structure and introducing the high-income phaseout, Congress is retaining the "right-side up" structure of the subsidy.

p. 742 — IRC § 129 Dependent Care Assistance Exclusion

For 2021 only, IRC § 129(a)(2)(D) increases the ceiling amount to $10,500 ($5,250 if the employee is married and files a separate return).

This temporary increase has expired.

These temporary changes have all expired.

p. 744 — IRC § 24 Child Tax Credit

For 2021 only, IRC § 24(i), added to the Code by the 2021 ARPA, increases the child tax credit amount to $3,600 in the case of a qualifying child younger than 6 years at the end of 2021, and to $3,000 in the case of other qualifying children. The provision also enlarges the definition of a qualifying child to include children who have not attained the age of 18 by the end of 2021

(rather than 17, as under the usual child tax credit rules). The total amount of the 2021 child tax credit (not the amount of the credit with respect to each child considered separately) is reduced by $50 for each $1,000 by which the taxpayer's modified AGI exceeds $150,000 (joint return), $112,500 (head of household), or $75,000 (any other case).

Although the per child credit amounts under the 2021 rules are larger than the usual $2,000 per child credit amount (in 2018 through 2025), the phaseout thresholds under the 2021 rules are much lower than the usual (2018 through 2025) thresholds of $400,000 (joint return) and $200,000 (any other case). Thus, the 2021 rules would actually produce smaller credit amounts (or no credit at all) for many higher-income parents than would be produced by the usual rules.

IRC § 24(i)(4) includes a convoluted "limitation on reduction" provision intended to insure that such parents are not disadvantaged by the special rules for 2021. The basic idea is that parents in 2021 should be entitled to child tax credits based on the usual rules or based on the 2021 special rules, whichever produces a larger credit.

The following example is based on an example in the House Report on the legislation (H. Rept. No. 117-7, at 730): The taxpayer is a head of household with modified AGI of $140,500, and with one qualifying child, age 7. Under the usual rules, the taxpayer would be allowed a $2,000 credit. Under the special 2021 rules, without regard to the "limitation on reduction" provision, the taxpayer would be entitled to a credit of $3,000, reduced by $1,400 to $1,600. (The $1,400 reduction is calculated as [($140,500 - $112,500)/$1,000] x $50 = $1,400.) However, with the "limitation on reduction" applying, the reduction will be only $1,000, and the taxpayer will be entitled to a $2,000 credit (reduced from $3,000 by the phaseout). The "limitation on reduction" rules provide that the phaseout reduction cannot exceed the lesser of (1) the difference between the 2021 full credit amount and the usual credit amount (here, $3,000 - $2,000 = $1,000), or (2) 5% of the difference between the usual phaseout threshold and the 2021 phaseout threshold (here, 0.05 x ($200,000 - $112,500) = $4,375). The result on these facts is that the reduction is limited to $1,000, and the credit is $2,000.

IRC § 7527A, also added by the 2021 ARPA, provides for advance payment of 2021 child tax credits, in periodic equal amounts totaling 50% of the taxpayer's anticipated total child tax credits for 2021. The anticipated credits are determined based on a taxpayer's modified AGI for a reference year, and on the taxpayer's qualifying children in that year (with adjustment for age). The reference year is generally the preceding year (2020), but it is 2019 if the taxpayer has not (or not yet) filed a return for 2020. The IRS may modify the annual advance payment amount—and thus the amount of the periodic payments—during the year to take into account a return newly filed by the taxpayer, or any other information provided by the taxpayer. The statute directs the IRS to establish an online information portal that taxpayers can use to provide credit-relevant information to the IRS, and to elect out of advance payments (in which case taxpayers can still claim their child tax credits on their 2021 returns, in the usual way).

As one would expect, advance payments received under IRC § 7527A reduce the amount of the credit a taxpayer can claim on her return, dollar-for-dollar. If advance payments exceed the proper credit amount based on actual 2021 results (which should not be common, given the

50% ceiling on advance payments), repayment by the taxpayer of the excess (known as "reconciliation") is generally required under IRC § 24(j). But if the taxpayer's actual modified AGI for 2021 does not exceed $60,000 (joint return), $50,000 (head of household), or $40,000 (any other case), reconciliation is not required to the extent of a "safe harbor amount," defined as $2,000 multiplied by the excess (if any) of the number of qualifying children taken into account in determining the amount of the advance payments, over the actual number of qualifying children under IRC § 24. For example, if the IRS determined jointly filing spouses' advance child tax credit payment by taking into account two qualifying children (based on the number of children claimed on their 2020 tax return), but the spouses only claim one qualifying child on the 2021 tax return, they would be protected from having to repay any excess child tax credit paid to the extent of $2,000. This safe harbor is phased out as modified AGI rises between the income threshold and 200% of the threshold.

p. 767 — The Earned Income Tax Credit

These temporary changes have all expired.

Add the following to the discussion in Chapter 9.E.2:

Legislation enacted since 2018 has significantly modified the EITC:

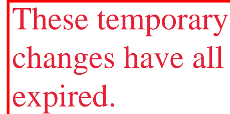
The 2021 ARPA temporarily expands EITC availability for childless workers and couples. ARPA § 9621. For 2021, the maximum credit for a childless worker has been increased to $1,502 (increased credit percentage of 15.3% x $9,820), and the credit is reduced by 15.3% of the amount by which AGI (or earned income, if greater) exceeds $11,610 ($17,560 for married taxpayers filing jointly). Rev. Proc. 2021-23. The age restriction is also relaxed, such that individuals who are at least 19 years old as of December 31, 2021 and who are 65 and older are now eligible for the childless worker EITC. However, full-time students under age 24 do not qualify for the credit. The minimum age is 18 for qualified former foster youth and homeless youth.

This one-year expansion of the "childless" EITC is expected to cost $11.9 billion.

In addition, there have been temporary changes in how earned income is calculated for purposes of the EITC. For 2020, Section 211 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (uncodified provision) permits taxpayers to elect to determine their EITC amount using earned income from the previous year (2019) in lieu of current year (2020) earned income, if 2019 earned income is larger. For 2021, ARPA § 9626 similarly allows taxpayers to use 2019 earned income in determining their EITC amount in lieu of 2021 earned income, if the 2019 amount is larger. These provisions apply to EITC claimants with and without qualifying children.

p. 806 — Earned Income Tax Credit and Problems of Anti-Poverty Program Design

See immediately preceding discussion (p. 767) for the effect of legislative changes since 2018 on the EITC. Those changes primarily affect childless workers, so they should not impact the answers to Problems 9.23 and 9.24.



p. 812 — Excessive Investment Income Rules for EITC

When working on problem 9.28, consider how the changes in the 2021 ARPA affect your analysis.

p. 812-14 — COVID-19 and Individual "Recovery Rebates"/Stimulus Checks

Add the following note at the end of p. 814:

The stimulus checks (also referred to as "recovery rebates") that were paid to qualifying individuals following the COVID-19 pandemic are an example of a cash transfer program that phases out at higher income levels. In light of the pandemic, Congress passed legislation that awarded three rounds of cash grants to qualifying taxpayers earning below certain income levels. The 2020 CARES Act provided an initial round of recovery rebates of up to $2,400 for married couples and $1,200 for single filers, plus $500 per qualifying child. Married taxpayers with income up to $150,000 ($112,500 for head of household filers; $75,000 for single filers) receive the full amount of the recovery rebate, and the rebate is gradually phased out for taxpayers with incomes above these levels.

The 2021 CAA provided a second round of individual recovery rebates. The maximum amount was $1,200 for joint return filers and $600 for individual filers, plus another $600 per qualifying child below certain income thresholds (up to $150,000 for joint filers, $112,500 for head of household filers, and $75,000 for single taxpayers). Again, the payment is phased out for taxpayers with income above these levels. Finally, the 2021 ARPA provided a third round of stimulus payments of up to $2,800 for married taxpayers filing jointly and $1,400 for individual filers, with an additional $1,400 for each qualifying dependent. The income thresholds at which taxpayers will receive the full amount remained $150,000 for married taxpayers, $112,500 for head of household filers, and $75,000 for single filers. Above these income levels, the rebate amount is phased out.

The individual recovery rebates paid in light of the COVID-19 pandemic have several notable design features. First, the grant amount is not explicitly tied to a work requirement. As long as the taxpayer has AGI at or below the stipulated levels, they will receive the rebate. Second, the grant amount is technically styled as a refundable tax credit and computed based on prior year income, meaning that even if the taxpayer didn't owe any taxes for the year, they still receive the cash grant. Thus, the recovery rebates are essentially a cash grant delivered through the tax system. To deliver the recovery rebates, the IRS had to take steps to ensure that eligible individuals who do not file tax returns ("nonfilers") received the credit, for example, by designing certain tools and outreach to obtain the relevant information from nonfilers. Third, the grant is not universal, but is only available to taxpayers below certain income levels. Finally, the recovery rebates are triggered by a specific economic crisis event, and are designed to stimulate economic recovery in light of dislocation caused by the pandemic. This makes the recovery

rebates different from a demogrant program that is paid annually regardless of overall economic conditions.

Notably, this is not the first time that Congress has paid stimulus checks to individuals to provide financial support or spur economic activity in light of an economic crisis. Stimulus rebates were also paid after the 2008 financial crisis and recession to individuals below certain income levels. Like the 2020 and 2021 payments, the 2008 payments were also delivered through the tax system.

In 2022, Congress increased this age to 73. For people born after 1959, it has increased to age 75.

CHAPTER 11:

p. 855-6 — Consumption Tax Treatment of Retirement Savings; Changes to Distribution Requirements

In 2019, Congress raised the age by which taxpayers must take a taxable distribution to age 72, rather than 70½. The change is effective for tax years after December 31, 2019. However, Congress also reduced the maximum time frame for many types of beneficiaries of an inherited IRA to withdraw distributions to 10 years after the death of the IRA owner. IRC § 401(a)(9)(H). This is less generous than the prior rule, which allowed required minimum distributions to be stretched over the beneficiary's lifetime. *See* IRC § 401(a)(9)(A)(ii) prior to enactment of IRC § 401(a)(9)(H). This rule does not apply to certain "eligible designated beneficiaries," including surviving spouses, minor children, and certain disabled individuals; such beneficiaries will continue to be allowed to stretch distributions over the beneficiary's lifetime. IRC § 401(a(9)(B)(iii), (E)(iii), (H)(i)(ii).

The effect of this new 10-year rule is that it allows the IRS to accelerate collection of income taxes on the distributions. Thus, for affected beneficiaries, the deferral benefit discussed on p. 856 of the casebook will be less than under prior law.

p. 856 — 2020 CARES Act and 2021 CAA Changes to Retirement Plan Withdrawal and Distribution Rules

The 2020 CARES Act and the 2021 CAA made a number of changes to the rules regarding early distributions and withdrawals. Here are some highlights: The CARES Act permitted eligible taxpayers (e.g., taxpayers diagnosed with COVID-19 or who experience certain adverse financial impacts due to COVID-19) to make COVID-19 related withdrawals of up to $100,000 from IRAs and qualified employer-sponsored plans in 2020 without the 10% early withdrawal penalty. Such withdrawals are included in taxpayer's income over three years. The CARES Act also waived required minimum distributions for 2020, as well as certain 2019 required minimum distributions. In addition, the CARES Act temporarily expanded the limitations for loans from qualified retirement plans, and also allows qualified retirement plans to offer a one-year suspension of loan repayments due from the date of enactment through December 31, 2020.

Like the CARES Act, the 2021 CAA also made some changes to the rules regarding retirement plan withdrawals and distributions, including by relaxing the distribution rules for tax-qualified retirement plans for non-COVID-19 related "qualified disasters" taking place and declared within specified dates, and temporarily relaxing the limit on loans to qualified individuals from retirement plans.