

Federal Personal Income Tax Outline
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Assignment Sheet 1

I. Introduction

- Regulation vs. Statutory Provision
 - Regs have the force of law and are passed by executive agencies
 - Regs must be based on a statutory provision and serve as interpretation of the statute.
 - Inconsistency b/w reg and statute → reg. wins
 - Rules: administrative announcements of IRS → merely serve to state the IRS position on something but do not have the force of law.
- Policy Considerations
 - We need a tax system as a way for government to fund itself
 - Tax system serves to allocate the cost of public goods and services among Americans on an ability to pay basis.
 - All economists believe there is one tax that does not have a disincentive effect → Head tax (e.g. if you are a person you get taxed)
- Most states have income and property taxes (fund education)
- Income tax is generally proposed at a marginal vs. flat tax rate (e.g. if under 25,000 → 0 tax → if 26,000 → tax at 20% = taxed on 1st 1000 above the 25,000.
- Generally tax rate is progressive → as income rises you pay a higher % to taxes.
- Consensus, that income from certain investments will be taxed
- Federal Income Tax also used as tool of social policy.
- Addressing Tax Liability → Things to consider:
 1. Gross Income
 2. Adjusted Gross Income
 3. Deductions
 4. Taxable Income
 5. Tax Rates

Problem 1 covers much of the semester.

8-20

Problem 2, b

5,000 is a type of compensation

POLICY QUESTION WILL BE ON THE FINAL

II. Gross Income

- Gross Income (§61): All income from whatever source derived, including but not limited to:
 - (1) Compensation for services, including fees, commissions, fringe benefits and similar items... See comprehensive list under statute.

- Gross income is generally includes items which add to the taxpayer's net worth.
- Regs. say that gross income may be realized in any form, whether money, property, or services.
- Forms of Receipt
 - If services are paid for in property → Fair market value (FMV) of property is the measure of compensation
 - FMV = the price a willing buyer would pay a willing seller, with neither under a compulsion to buy or sell and both having a reasonable knowledge of relevant facts.
 - If paid for in the form of services, the value of the services received is the amount of compensation.
- Test of Income where §61(a) does not explicitly list (Glenshaw glass):
 1. Undeniable accessions to wealth
 2. Clearly Realized AND
 3. Over which taxpayer has complete dominion
- Complete dominion is defined as being able to do whatever you want with the \$
- Generally treasure trove, to the extent of its value in US currency, constitutes gross income for the taxable year in which it is reduced to undisputed income (Cesarin v. United States)
- The payment by an employer of the income taxes assessable against the employee constitute additional taxable income to such employee (See Old Colony Trust)
- In a situation where an employer pays an employee's expenses on a trip that is a reward for services rendered by the employee, the value of the reward must be regarded as income to the employee.
- Situations where employee uses frequent flyer miles earned from work travel to cash in for a non-business related trip does not equal taxable income.
- **Tax Free Fringe Benefits**
 - Under § 61 gross income includes fringe benefits
 - Other parts of the code, judicial rulings and administrative rules modify this general standard.
- 1. **Meals and Lodging (§ 119)**
 - Until § 119 was enacted rule of Benglia v. Commissioner was standard: If meal and lodging = value to employer (e'er) than it did not = income to the employee (e'ee)
 - To see if § 119 is satisfied ask 5 questions and if all answers = yes than value of the m/l is excluded from income?
 - a. Are the meals/lodging (m/l) a convenience to the employer?
 - (i) Meals furnished by e'er w/o charge are considered furnished for the convenience for the employer if such meals are furnished for a substantial non-compensatory business reason of the employer (see Reg.1.119-1)
 - (ii) Generally meals furnished before or after working hours will not be regarded as furnished for the convenience of

the e'er w/exception of food service employee
(restaurant/casino, etc.)

- b. Are meals provided on the business premises
- c. Is lodging a condition of employment?
- d. M/L provided to employee (or spouse & dependents)?
- e. Are meals provided by or on behalf of employer?

2. Work related Fringe Benefits (§ 132)

- Enactment of § 132 stopped development of common law/non-statutory fringe benefits b/c Congress was concerned that:
 - 1. Conception that e'es and e'er were negotiating to have income in terms of fringe benefits vs. compensation and undermining taxes.
 - 2. Administrative problems: Tax law we interpret the law ourselves when we do our own taxes and audits are rare.
- § 132 lists 7 things that are excludable as fringe-benefits

1. No additional Cost Service

- a. Service must be one offered for sale to customers in the ordinary course of business (e.g. airline offers air travel)
- b. Must be in line of business of e'er (Regs say that performance of substantial services directly benefiting more than one line of business is treated as performance of sub. services in all such lines of business (e.g. lawyer deals with all legal services of a hotel/airline chain))
- c. Employer must incur no **substantial** cost (including foregone revenue) → cost that is not substantial doesn't count.
 - Foregone revenue: If somebody reserves something there is usually a rebuttable presumption that it is foregone revenue
- d. Must be offered by employer to employee
- e. Cannot discriminate in favor of highly compensated e'ee

2. Qualified employee discount

- §132(c)(1): QED = any employee discount w/ respect to qualified property or services (any property or services which are offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services) to the extent such discount does not exceed:
 - (a) in the case of property, the gross profit percentage (GPP) of the prices at which the property is being offered by the employer to customers, OR
 - Excludible amt = GPP x (Normal Price of the item)
 - GPP = aggregate profit/aggregate sales price (comes up to a percentage) and that % is multiplied by the normal price and that number is subtracted from the price the employee paid to get the amount of taxable income (see problem on 198).
 - (b) in the case of services, 20% of the price at which the services are being offered by the employer to customers.
- Real property and personal property held for investment do not qualify for §132(c) exclusion b/c of congressional concern fraud.

3. Working condition fringe

- Property or service so closely connected with job performance, that were the e'ee vs. e'er to pay for them the e'ee would be entitled to deduct the cost as a business expense.
- Regs provide that cash payments do not = working condition fringe unless e'ee is required to use the payments for expenses incurred in a specific or pre-arranged qualifying activity, verify such use, and return any excess to the employer.

4. De minimis Fringe

- Any property or service the value of which is (after taking into account the frequency with which similar fringes are provided by the employer to the employer's employees) so small as to make accounting for it unreasonable or administratively impracticable

5. Qualified transportation fringe

- Policy decision of Congress to encourage use of mass transit and carpooling.
- QTF includes:
 - a. Transportation in a commuter highway vehicle if connected w/ travel b/w e'ee residence and place of employment.
 - b. Any transit pass
 - c. Qualified parking
 1. Provided on or near business premise
 2. Provided by e'er to e'ee
- Non discrimination clause of 132(j) applies to a(1) and a(2) so if a firm only gives qualified parking to partners that's okay.

6. Qualified moving expense reimbursement

7. Qualified retirement planning services

- For purposes of § 132 employee is defined to include one's spouse and dependent children

3. Other Statutory Fringe Benefits

- §79: Group term life ins. purchased for employees is includible as income BUT only to extent that such cost exceeds the sum of:
 1. The cost of 50,000 of such insurance AND
 2. The amount (if any) paid by the employee toward the purchase of such insurance.
- Cost of 1st 50,000 is not taxable if e'er provides 500,000 worth of insurance but the remaining 450,000 is.
- §106(a): Gross income of an employee does not include employer-provided coverage under an accident or health plan.
- If employer pays premium to HMO etc on behalf of e'ee it is not included in gross income

- This tax provision accounts for 1/4 of deficit in tax revenues
- §106: Except as otherwise provided in the section, gross income of an employee does not include employer-provided coverage under an accident or health plan.
- Under tax law none of premium paid by employee for health is taxable → this accounts for 1/4 of deficit
- Big employers may self-insure & promise to pay medical bills as they arrive and this does not = gross income for the employee
- §105: deals with amounts paid/received under accident or health plan (amounts ins. company pays to you to reimburse Dr. or paid to Dr. directly)
- § 105(a) generally says that amounts received by employee through accident or health ins. shall be included to extent they are
 1. attributable to contributions by employer which were not includible in gross income of employee OR
 2. Are paid by the employer
- § 105(b) however allows that gross income does not include amounts included in (a) if they are paid directly or indirectly to the TP to reimburse the TP for expenses incurred by him for the medical care (as defined in §213) of TP, TP spouse, & dependent.
 - Amount = to salary does not = medical care under §213 so = gross income under §105(a) (e.g. if the ins. company gives you a payment in lieu of salary that you will miss b/c of your injury this should be included as gross income)
- §105(c) that payments unrelated to absence from work do not = gross income to extent they are:
 1. constitute payment for permanent loss of a member of function of the body of TP, spouse, or dependent AND
 2. computed w/ reference to the nature of the injury w/o regard to the period the employee is absent from work. (e.g short term disability payments)
- §213: defines what is medical care and is thus excluded under 105(b)
 - Cosmetic surgery is not treated as medical care w/ some exceptions so pmt. that e'ee receives for cosmetic surgery is includable in gross income.
 - Congress has decided that tax benefit should not extend to cosmetic surgery b/c it is more elective except for the exceptions listed.
- Societal benefit of these exclusions for medical care when it results in billions of dollars of lost tax revenue
 1. Ensure healthy workforce
 2. Save on tax b/c if got cash you would get taxed on it (e'ee benefit)
 3. Economy as a whole/consuming stuff
 4. Government does not provide health ins.
 5. Ins. company gets more business
 6. More revenue to government when people are working
 7. Doctors and hospital get paid

III. Gifts, Inheritances, and Scholarships

1. Gifts or Compensation

- Congress has specifically excluded gifts from income
 - §102: General rule: Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.
 - Motive of the donor is critical in characterizing receipts as gifts under 102
 - Gift in statutory sense proceeds from a detached and disinterested generosity...out of affection, respect, admiration, charity, or like impulses (Commissioner v. Duberstein)
- Determination of the issue of whether something is a gift or not is very fact specific and must be based ultimately “on the application of the fact finding’s tribunal’s experience with the mainsprings of human conduct to the totality of the facts of each case”
 - When parties have an economic association usually very hazy as to whether it’s a gift or not
 - §102(C): Any amount transferred by or for an employer to or for the benefit of an employee does not = a gift (e.g. a Christmas bonus by the boss = taxable income)
 - Regs day however that this provision does not apply to amounts transferred b/w related parties if the purpose of the transfer can be substantially attributed to familial relationship.
 - True test of a gift: whether in actuality the gift is a bona fide gift or simply a method of paying for compensation (resolved by examination of the intent of the parties) (Wolder v. Commissioner)
 - §274(b): No deduction allowed for any expense for gifts made directly or indirectly to any individual to extent expenses for all gifts in that year exceed \$25.
 - Gift here is as defined in § 102 but does not include:
 - a. an item having a cost to the TP not in excess of \$4.00 on which the name of the TP is clearly and permanently imprinted and which is one of a number of identical items distributed generally by the TP
 - b. a sign, display rack, or other promotional material to be used on the business
2. Treatment of Inherited Property
- §102(b): does not allow the income from any gift, devise, or inheritance to be excluded as income (e.g. the dividends from a gift of stock are not excluded, only the actual gift itself is excluded as gross income) OR
 - §102(b) also says that where the gift is of income from property, the amount of such income is not excluded.
3. Scholarships (§117)
- Gross income does not include any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization
 - Qualified scholarship = amount received by an individual as a scholarship for qualified tuition and related expense
 - Qualified tuition= tuition and fees for enrollment or attendance of a student and fees, books, supplies, and equipment required for courses of instruction at such an educational organization.

- No exclusion allowed for scholarship amounts earmarked for non qualifying purposes such as room & board
- No exclusion is allowed for scholarship amounts that constitute payment for services (e.g. graduate student who is a TA must prove money is more for studying than teaching which is often hard to do)
- Qualified tuition reduction programs (special fringe benefit for employees of educational institutions and their family members) are non taxable, provided they do not discriminate in favor of highly compensated employees even though they are clearly compensatory in nature
- Non-qualifying scholarships and fellowships are generally includable in gross income according to regs.
- Employer payments for educational assistance to the employee are excludable up to 5,250 and are subject to various other restrictions.

IV. Gains derived from dealings in property

1. Introduction to the Realization and Replacement of Capital Principles
 - §61(a)(3) includes as gross income gains derived from dealings in property
 - In order for gain to be computed there must be a realization event (e.g. the sale of stock, the sale of property, dividends declared)
 - §1001(a): Gain from sale or other disposition of property shall be the excess of the amount realized over the adjusted basis (see §1011) and the loss shall be the excess of the adjusted basis (provided in such section for determining loss) over the amount realized.
 - Amt. realized (§1001(b)) = FMV of the property + money received
 - Adjusted basis (§ 1011) – basis = cost of property
 - Gain = amt. realized – adjusted basis (see Melissa stock example on pg. 76)
 - Basis is based on history (cost of property) not value at the time of the exchange.
 - Rule of Law from case law= when two taxpayers exchange property in a fully taxable transaction than the basis shall be the FMV (fair market value) of the property acquired in the exchange (see problem in book)
2. Basis of Property
 - §1012 defines basis as cost
 - Recourse liabilities assumed by a taxpayer in the acquisition of property are included in the TP basis in that property AND
 - Recourse liabilities of a seller, assumed by a purchaser, are included in the seller's amount realized.
3. Basis of Appreciated Property Acquired by gift (§1015)
 - §1011 exception – Taxation of gifts and bequests
 - §1015(a): basis of property acquired by gift is the same as would be in the hands of the donor (w/ exceptions) → Transferred/Substituted basis rule
 - e.g. if G transfers a business to TP, his daughter and the original cost of the business to him was \$4,000 and by the time he transfers it to TP it is worth

\$10,000 → When TP sells it for 18,000, it her basis is 4,000 and she has a gain realized of 14,000.

- §1015 imposes a basis that overtaxes recipient to make up for fact that G was not taxed on the gain he made from when he originally bought it to the time he transferred it to TP.
 - Shifting of gain is allowed but shifting of losses is prohibited
4. Property Acquired from Decedent – Stepped up basis
- §1014(a): The basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall be equal to FMV of the property at decedents death (stepped up basis)
 - Only that appreciation occurring after the decedent's death will be taxed & if property decreased in value during lifetime of decedent this negates the loss inherent in the property → Why?
 1. May be hard to figure out what the basis was for the donor/bequeather
 2. Estate tax is taxed anyway
 3. Benefits mainly go to rich with a lot of property concerns
 - §1014(e): If appreciated property was acquired by the decedent by gift during the 1 yr period ending on the date of decedents death and such property is acquired from the decedent by the donor of such property the basis of such property in the hands of the donor shall be the adjusted basis of such property in the hands of the decedent immediately before the death of decedent.
 - Established to prevent someone from trying to get the benefit of stepped up basis by transferring an appreciated property to someone who they know is dying and who will bequeath the property to them and thereby avoid being taxed on the appreciation (see Count D problem to understand this more)

V. Treatment of the owner of annuity and life insurance contracts

1. Life insurance: substitute for income insured individual would have generated had he/she continued to live.
 - §101(a): Life insurance proceeds paid by reason of the death of insured are excluded from gross income.
2. Individual Retirement Accounts (see IRA h/o) (§ 219, 72(t))
 - Deferred annuity/Non-Deductible IRA
 - Initial income is taxed at applicable tax rate for TP in that year → TP then invests the after tax earnings in this type of IRA and the investment income will not be taxed until money is w/drawn from account.
 - TP will have to pay tax on all investment income when w/drawn but still ends up with more \$ than if you had put it in your bank account with an equal interest rate
 - This option gives TP option to postpone income or accelerate deductions
 - Only difference is timing of when pay tax on the investment income
 - Goal of TP:
 1. Postpone income until latest possibility for TP
 2. Get deductions as soon as possible b/c reduces amount of taxes
 - Deductible IRA

- Opening balance for this type of IRA is full amt earned b/c TP can deduct amt. contributed to IRA against income for the year
 - Contributions to this acct. are tax deductible
 - As compared w/ a bank acct. they may have the same interest rate but TP is better off b/c more money is earning interest so even though when TP w/draws the \$ she has to pay taxes on the original \$ invested + the amount of investment income (interest credited) she still ends up with a lot more.
 - Roth IRA
 - Structurally different from deductible IRA b/c when earn income it is subject to tax the year it is earned but when w/draw \$ investment income is not taxed
 - IRC code provides penalty for taking \$ out of IRA prior to retirement unless it is taken out to finance your first home (see §72(t))
 - Only allowed to put up to a specified amount in a Roth IRA
 - Best to use a non-deductible IRA when not eligible for deductible IRA or want to invest more than allowed to in Roth and Dedcutible IRA
3. Annuities (§72)
- Annuity: a series of payments over a period of time
 - Historically annuities were series of payments made monthly/annual to a wealthy TP widow – Why?
 1. Payments guaranteed over life of surviving spouse
 2. Annuities take spending control out of hands of surviving spouse so they can't waste it
 - This type of annuity is rarely used today
 - Today, annuity used more in compensation planning for retirement
 - Ins. co. or employer makes pmt. of percentage of someone's salary unity they die (pension plan) – Federal government does this.
 - Tax issue in connection with annuities deals with following situation:
 - TP invests 100,000 to purchase annuity (this is equal to TP basis for tax purposes) → at retirement TP gets 10,000 per year and TP life expectancy is 25 years (as gotten from some table made up by treasury)
 - TP will get 250,000 over the 25 year spans and he has made 150,000 profit (250,000 – 100,000 of original investment)
 - Issue becomes: What is the proper way to tax the 10,000 that TP gets each year?
 - § 72: a certain portion of each annuity payment treated as return of TP investment
 - Excluded portion/expected total annuity so in above example it would be $100,000/250,000 (25 \times 10,000) = 40\%$ so under § 72 40% is treated as untaxable return on TP initial investment and 60% is taxable income.
 - Each year TP gets 10,000 and 4000 excluded from taxable income (40%) and 6,000 (60%) taxed so over 25 years $\times 6,000 = 150,000$
 - Taxwise if live longer than expected than the 10,000 becomes fully taxable
 - If you live shorter get deduction by amount of basis for amt. pd.

VI. Transactions involving indebtedness

1. Loans: Illegal and Legal

- Loans do not equal gross income → Loan proceeds are accompanied by an equal and offsetting obligation to repay so no real accession to wealth
- If part of loan is forgiven than either:
 - a. The part that is forgiven may constitute income b/c you no longer have that offsetting liability
- Under § 102(c) if forgiveness is from parent to a child may = nontaxable income as a gift
 - b. If at outset employer tell you don't have to pay whole thing → could be looked at as compensation under §102(c)
- Relationship b/w parties tells you what the consequences of loan forgiveness are
- Something is characterized as a loan only if it is an obligation to repay
- Illegal income must be reported but source of the income does not have to be reported. (James v. United States)
- Ct. in James holds that since embezzler doesn't intend to pay \$ back and from employer pt. of view there was never intent to lend so ct. says it should not be considered as a loan
- Lack of concensual obligation to repay or intention to repay makes it an income earning activity.
- Result may be unfair to victims b/c victims can never recover the full amount of embezzled funds just amount less taxes & there might not be \$ left to pay victim back after taxes, penalties, & spending.
- Victims get embezzlement deduction

2. Cancellation of Indebtedness

- Generally according to §61 → cancellations of indebtedness = income
- §108 has exceptions to this rule where certain discharges of indebtedness are taxable
 1. Title 11 bankruptcy proceedings
 2. Discharge occurs b/c debtor is insolvent to extent of TP insolvency
 - No income arise from discharge of indebtedness if the debtor is insolvent both before and after the transaction; and if the transaction leaves the debtor with assets whose value exceeds remaining liabilities, income is realized only to the extent
 - Insolvent is defined as excess of liabilities over the FMV of assets
 - Excess is determined on the basis of the TP assets and liabilities immediately before the discharge
 - TP must prove with anything claimed to be a liability that as of insolvency calculation date, it is more probable than not that he will be called upon to pay the obligation in the amount claimed.
 3. Qualified Farm indebtedness
 4. Qualified real property indebtedness

- Usually when you repay loans you do not have income b/c the transaction does not make you richer but in situation where pay back for less \$ than paid for and are richer than = income (Kirby Lumber)
- §108(e)(5) :If there is exclusion in income as result of renegotiation there should be a change in basis as well so if the debt of a purchaser of property to **the seller of such property** which arose out of the purchase of such property is reduced, such reduction does not occur
 - a. in a title 11 case or
 - b. when the purchaser is insolvent and
 - c. but for this paragraph such reduction would be treated as income to the purchaser from the discharge of indebtedness, then such reduction shall be treated as a purchase price adjustment.
- Change in basis under § 108 does not occur if renegotiation amount is reduced but not from seller of property → if from anyone else than it is just discharge of loan indebtedness & thus = gross income.
- §108(b)(5) allows TP to elect to apply any portion of debt reduction to reduction of basis of depreciable property of tax

VII. Treatment of Damage Recoveries

1. Damages to property or to business interests
 - Common law rule on taxation from Raytheon v. Commissioner
 - Ct. says that in these case the question that needs to be asked is “In lieu of what were damages were awarded?” – How would TP have been taxed had they received the benefit directly? So if damages were compensation, than treat as compensation
 - Where the suit is not to recover lost profits but is for injury to good will, the recovery represents a return of capital and, with certain limitations is not taxable.
 - Compensation for good will in excess of it’s cost is gross income
2. Damages for personal injuries (§ 104(a)(2)-(3))
 - Excludes from income any damages received as a lump-sum or periodic payment on account of personal physical injuries or sickness.
 - Damages excluded are those received through prosecution or settlement of tort or tort type rights.
 - Punitive damages are not excluded b/c TP is enriched so = gross income
 - Lost wages are excludable b/c reason lost is on account of personal physical injury or physical sickness.

VIII. Tax exempt Interest

- §103: Gross income does not include interest on any state or local bond
- Supposed to encourage building up schools and roads
- States benefit b/c get \$ at very low interest rate = subsidy that acts revenue sharing from fed. gov’t to state gov’t indirectly.

- Interest income from most state gov't bonds are tax free unless fails certain technical requirements = drive down interest payments tax will yield – reducing yield has to do with measuring income.

IX. Social Security Benefits

- §86(a)-(D)1
- On paycheck FICA = SS taxes – mandated by law for employer to w/hold these taxes
- For more than ½ the population SS taxes represent greater tax burden than income tax → most receive far more benefits in SS than they pay out
- 6.2% of wages to OASDI (up to 87,000)
- 1.3% of all wages (Medicare)
- Employer out of his own resources an add'l 6.2% and 1.3%
 - How is SS really funded?
- Most of what gets paid in each year gets paid out to current retirees not saved for me
- Medicare = entitlement you get by turning 65 → rates of reimbursement or healthcare community set by Federal government
- Amount of \$ that comes in for medicare is projected to be inadequate by end of this decade
 - §86 mandates that at most 50% of SS included in income & low income individual none is included for an individual whose base amount = in case of single person is higher than 25,000 and for married people 32,000
- To determine if you fall under or above base amount need to know the modified adjusted gross income + ½ of the SS benefits received (see (b)(1))
- If you fall above amount of your base amt (depending on whether you are single or married) than to determine on how much you'll be taxed see § 86(a)(1)(a) → Gross income for taxable year includes SS benefits in amt. = to lesser of:
 1. ½ of SS benefits rec'd OR
 2. ½ of excess described in (b)(1)
- The percentage of tax will depend on the person's tax bracket.

Assignment Sheet 2

Property Transaction: Realization, Recognition, Etc.

I. Introduction

- Tax system is on realization system → TP does not have income until sale or disposition of property
- Exchange of property gives rise to a realization event so long as the exchanged properties are materially different – that is so long as they embody legally distinct entitlements (Cottage Savings v. Commissioner)

- As long as TP has materially different rights and risks with respect to assets there has been a realization event.
 - For tax purposes 2 requirements for gain to be included or loss deducted:
 1. Gain must be realized (case law)
 2. Gain must be recognized (statutory)
- Recognition: Has IRC determined that realized gain or loss will be taxed currently or at a later time.
- HYPO: If prof. receives for compensation 100,000 of cash and 400,000 in IBM stock does he have 500,000 worth of income or 100,000? 500,000 b/c he got stock at 1 moment in time (didn't own it all along) and it's compensation → Realization requirement & property model only comes up when you are already owner

II. Realization when property transferred as compensation

- IRC § 83: defines circumstances where TP right are not complete enough to be taxed.
- 4 issues to see how § 83 applies:
 1. Does § 83 apply to a transaction? 2 pt. test:
 - a. Performance of services connection AND
 - b. Property transferred to other person
 2. Who has income?
 - Person who performed such services
 3. When is there income?
 - 1st taxable year in which rights in property are transferable OR are not subject to a substantial risk of forfeiture
 4. How much income does the TP have?
 - Employer can include it as a deduction in the year the e'ee includes it as income
 - SEE STAR lawyer example in notes and syllabus
- Election under § 83(b) allows e'ee to include in income the item the year she received it and assume the risk of forfeiture as opposed to waiting until it's free and clear.
- § 83 = Income w/o realization

III. Nonrecognition of Gain or Loss in Certain Property Dispositions

1. Property Settlements in the Context of a Marital Dissolution
 - § 1041: No gain or loss recognized on transfer of property to spouse or former spouse ONLY if transfer is incident to divorce and occurs w/i 1 year → treated as a gift and basis of transferee in property = adjusted basis of transferor.
2. Like Kind Exchanges (§ 1031)
 - Under § 1031 no gain or loss recognized when property held for productive use in a trade or business or for investment is exchanged solely for property of "like kind" to be held for productive use in a trade or business or for investment (Non-recognition rule)

- § 1031:
 - 1.) Exchange of Property
 - 2.) Held for productive use in trade or biz
 - Look at TP purpose for holding new property & old property NOT other person
 - Property given up in exchange & property received must both be held for productive use in a trade or business or for investment purposes.
 - An exchange may not qualify under § 1031 where the intent at the time of the exchange is to make a charitable contribution of the property received.
 - 2 year holding requirement on exchanges b/w related persons.
 - 3.) Exchanged solely for property of like kind
 - Regs state that like kind = nature or character of property, or its kind or class, not to its grade or quality.
 - For real property, whether real estate is improved or unimproved is immaterial it = like kind
 - Property held for personal use by TP is NOT held for investment so falls outside of scope of § 1031
 - Question of motive – stuff held for income earning vs. for personal use
 - Non recognition rule is premised primarily on the notion that the property received is simply a continuation of that investment in a modified form
 - Money is not in like kind with any other property
 - Questions to answer for each transaction
 - a. Gain realized
 - b. How much?
 - c. Like kind?
 - d. Amt. not like kind?
 - If exchange would be w/i § a but is not b/c it consists of like property + boot (other stuff to add up to value) than realized gain shall be recognized BUT not in an amt. in excess of the sum of such \$ & FMV of the boot property.
 - e. Amt. of gain recognized
 - f. Basis of new property
 - g. Any errors?
 - § 1031 (d): Basis in new property is the same as property exchanged.
 - NOTE EXAMPLES IN THE SYLLABUS AND IN THE BOOK FOR COMPUTING THIS
 - Policy rational for non-recognition = in exchange of property no liquid assets to pay taxes so don't want to be a tax burden.
3. Involuntary Conversions (§ 1033)
- Deals with rare events when TP property is involuntarily converted to something else → applies when property as result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof is compulsorily or involuntarily converted. . .

- Gov't may acquire property by requisition or condemnation – this is involuntary OR if TP believes gov't is going to requisition property and strikes a deal for sale and buys new property than § 1033 applies
 - IF TP only pockets \$ and doesn't buy new property than § 1001 governs
 - § 1033(a)(2) – TP replaces property converted with similar property → No Gain recognized – allows TP to get cash but not taxed b/c TP had no choice in exchange/transfer.
 - Realized Gain will exist to extent that amount received upon the conversion exceeds the cost of the replacement property.
 - Property converted must be similar or related in use
 - Attention directed primarily to the similarity in the relationship of the services or use which the original and replacement properties have to the taxpayer/owner.
 - Replacement property must be purchased for the purpose of replacing the property so converted.
 - Generally property must be replaced within a 2 year period following the conversion of the property.
 - Basis of replaced property shall be the cost of such property decreased by the amount of gain realized on the conversion which as a result of § 1033 was not recognized.
4. Transactions Involving Residential Property (§ 121)
- Gross income does not include gain from sale/exchange of property if:
 1. During 5 yr. period – property must own for an aggregate of 2 out of 5 years
 2. Used as TP principal residence for 2 out of 5
 3. No portion included in income up to specified dollar amounts
 - For single couple exclusion = up to \$250,000
 - For married couple exclusion = up to 500,000 if:
 - a. either spouse meets ownership requirements
 - b. both spouses meet the use requirement
 - c. neither spouse is ineligible for the benefits
 - If such spouses do not meet the requirements the limitation is = to what each spouse would be entitled to if unmarried (i.e. 250,000)
 - For unmarried people living together each may deduct 250,000

IV. Deductions and Credits – Business Expenses

1. Overview & General Principles (§ 162)
 - To measure income need to have method to deduct expenses used to gain the income
 - Requirements for deduction of costs associated with a business under § 162:
 - a. The cost must be an expense
 - b. The expense must be ordinary
 - Defined as something that typically happens in the life of a business (Welch v. Helvering)

- Transaction which gives rise to it must be of common or frequent occurrence in the type of business involved
 - c. It must be necessary
 - Defined as appropriate & helpful
 - d. Incurred in
 - e. Carrying on a
 - f. Trade or business
 - TP must be involved in the activity with continuity and regularity and the taxpayer's primary purpose for engaging in the activity must be for income or profit.
 - 2 problems to be considered with deductions:
 - 1) Capital expenditures: amt. paid to acquire an asset that will last some significant amount of time
 - 2) Quasi-personal expenses: no deductions for personal/family living expense but how deal with those in between
- 2. Reasonable Compensation
 - § 162(a)(1): Reasonable allowance for salaries or other compensation for personal services actually rendered are deductible by e'er.
 - Unreasonably large salary is not an ordinary and necessary expense of a business
 - Historically combination of factors have been used to determine reasonableness
 - a. Position held by the employee
 - b. Hours worked and duties performed
 - c. The general importance of the e'ee to the success of the company
 - d. A comparison of past duties & salary with current responsibilities and compensation
 - e. A comparison of the e'ee salary with those paid by similar companies for similar services
 - f. The size of the company, the complexities of the company's business and the general economic conditions
 - g. The existence of a potentially exploitable relationship between the taxpaying company and it's employees
 - h. The existence of a bonus system that distributes all or nearly all of the pre-tax earnings of the company.
 - Clothing may be deducted for police officers, firemen, letter carrier, etc for those required to wear distinctive types of uniforms while at work which are not suitable for ordinary wear (Pevnsner v. Commissioner)
 - Deduction may be denied on public policy grounds
 - Test of non-deductibility always is the severity and immediacy of the frustration resulting from the allowance of the deduction. Flexibility of such standard is necessary to accommodate both the congressional intent to tax only net income & the presumption against congressional intent to encourage violation of declared public policy (Tank Truck Rentals v. Commission holding that to permit deduction of fines imposed by the state would only encourage noncompliance by taking the sting out of the penalty).

- Lobbying: § 162 (e): disallows any deduction for amounts paid or incurred in connection with:
 - 1.) Influencing legislation OR
 - 2.) Any direct communication with a covered executive branch official in an attempt to influence any legislation through communication with any member or employee of a legislative body.
- 3. Employee Business Expense
 - Expenses incurred by an employee in finding work in the same trade or business satisfy carrying on requirement & costs (e.g. resume cost, postage, etc.) are deductible
 - To determine whether employment seeking expenses were incurred in e'ee current trade or biz or in seeking new trade or biz → compare position which the TP occupied before & after the change
 - Reimbursement received by an interview need not be included in gross income
 - Prolonged period of unemployment will terminate one's status as being engaged in a trade or biz.

V. The Distinction between Deductible Business and Investment Expenses and Nondeductible capital

1. Introduction (§ 263)
 - Deduction denied capital expenditures: cost of new buildings or for permanent improvements or betterments increasing the value of the property and for restoration costs for which an allowance is made.
 - Disallowance applies to expenditures that add to the value or substantially prolong the useful life of property or adapt property to a new and different use BUT not to incidental repair and maintenance.
 - Capital expenditure: provides a benefit that contributes to income over a period of years → value is not consumed or dissipated within current year.
2. Defining Capital Expenditures
 - Indopco decision: focus = whether expenditure at issue generated future benefits and whether those benefits were significant → Query whether the creation of significant future benefit is essentially equivalent to the acquisition of property having a useful life substantially beyond the taxable year (Reg. 1.263 (a) – 2 (a))
 - Advertising costs are generally deductible despite the fact that they have long term benefits.
 - Revenue Ruling 2001-4: Repair & Maintenance Expenses are incurred for the purpose of keeping the property in an ordinarily efficient operation condition over its probable useful life for the uses for which the property was acquired.
 - Capital Expenditures(in contrast): for replacements, alterations, improvements, or additions that appreciably prolong life of the property, materially increase its value, or make it adaptable to a different use.
 - Relevant distinction b/w CI & Repairs is whether the expenditures were made to put or keep property in ordinary efficient operation condition

- Even if expenditures include replacement of numerous parts → if parts are minor portion of physical structure of the asset, asset as whole has not gained materially in value
3. Acquisition & Disposition of Assets
- Costs incurred in defending or perfecting title = capital expenditures & are non-deductible
 - Where dispute does not relate to title to property but to income from it → expense has been held deductible.
 - § 263A: requires capitalization of direct & indirect costs (including certain interest costs) incurred by TP who manufacture, construct, or produce real or tangible personal property, or who acquire or hold inventory property for resale.
 - To extent an expenditure:
 1. Creates or enhances a separate and distinct asset
 2. Produces a significant future benefit
 3. Is incurred in connection with the acquisition of a capital asset (expenditure is directly related to acquisition) → expenditure must be capitalized.
 - When wages are paid in connection with the construction or acquisition of a capital asset, they must be capitalized and are then entitled to be amortized over the life of the capital asset so acquired (Commissioner v. Idaho Power)
4. Repair vs. Improvement
- Regulations @ § 1.162-4 & 1.263(a)-1(b) provide that expenditures for repairs or maintenance which do not materially add to value or appreciably prolong useful life, are deductible → Replacements or improvements are not.
 - Test 1: Does repair restore property to normal operating condition or materially increase value?
 - Material increase = what an ordinary investor may think important in making investment decision.
 - E.g. add a/c to truck so now it can ship higher value furniture – truck becomes more valuable b/c people would pay more for a/c so materially increases value
 - Test 2: Does it appreciably prolong life?
 - Expenditures that exceed materially beyond close of the year = capital expenditures (e.g. cleaning supplies for 2 years)
 - Employee training costs are generally deductible business expenses.
 - Where something has not improved productive capacity = ordinary & necessary business expense = repair = deductible (Midland Empire)
 - Where improvement does not improve structure for what it was designed to do = repair although value of property increased.
 - Test: Does it materially add value? Look at time period from when property was operated in normal fashion to repair
 - Distinguishing factor to court may be foreseeability of repair (Mt. Morris Drive-in): if TP had fixed problem in beginning it would have been a capital expenditure as part of cost of acquiring & setting up theatre.
5. Expenses with Respect to a New Business
- §195 – new business costs are treated as capital expenditures

- Allows expenses to be deducted over 1st 5 years business operations
- § 195(c): specifies what is eligible in deduction for 1st 5 years

VI. Recovery of Capital Expenditures

1. Depreciation and the Accelerated Cost Recovery System (see Depreciation handout)

- Cost recovery system whereby TP may claim depreciation deductions – allows TP to write-off or deduct their capital investment (or cost) over time
- Deduction allowed over a period of years that represent portion of cap. Expenditures used up in a given year
- § 167: reasonable allowance for the exhaustion, wear, and tear of:
 1. Property used in trade or business OR
 2. Property held for the production of income
- Property that lasts a short period of time – expenses usually deducted immediately
- TP purchases land on which it will build something – land is forever so no deduction for cost of land when purchased or used BUT he may deduct cost of land when property is sold on gain
- Property that value tends to decline over years it is used in business – harder to determine → 3 concepts:
 1. Useful life: How long is asset expected to last in general?
 2. How quickly does asset decline in value? Rate of Decline
 3. Salvage value: Value of asset at end of expected useful life
 - If you know all of these 3 factors you will be able to tell how much depreciation is useful in any given year.
- Straight line depreciation: one merely divides the cost of the asset by the number of years in the recovery period to determine the depreciation allowance for the given year
 - Assumption of straight line – if graph decline on chart assumes property declines by the same amt. each year
 - TP only allowed depreciation up to amount paid for car – if car last over predicted/assumption no deductions in following years allowed
- Accelerated Depreciation/Double Declining Method
 - Assumes property declines in value much more quickly than on a straight line basis
 - Pg. 334: table of percentage of depreciation that will always work in problems – see h/o and you'll notice percentages are correct
- § 168: deals with computing for tangible property – use:
 1. Applicable depreciation method
 2. Applicable recovery period
 3. Applicable convention
 - Salvage value is treated as 0
 - For our class assume ½ year convention (all property is used in 1st year starting July 1)
 - Subsection b:: describes which method to use for certain property
 - Subsection C – table

- Real property – 27.5 years = applicable recovery period
- Non- residential real property (office bldg.) – 39 years = applicable recovery period
- Pg. 332 in textbook: list of recovery periods – class life as determined by engineers – typically shorter than actual use
- Sec (e)(1) puts classification of property depending on class life at accelerated rate so need to compare 2 charts of book & e(1)
- Sec. 168 allows accelerated deductions for depreciation of assets
- 168(k) allows more generous depreciation (50% vs. 30%)
- Recovery property = tangible property of a character subject to the allowance for depreciation and placed in service after 1980: elements
 1. Tangible
 2. Placed in service after 1980
 3. Of a character subject to the allowance for depreciation
 4. Used in the trade or biz or held for the production of income
 - Generally if an asset is being used as art and NOT in it's usage subject to wear and tear than it is not a depreciable asset.
- 2. Other Depreciation Matters**
 - Despite general rule that no current deduction is allowable for costs incurred in acquiring an asset with a useful life extending substantially beyond the tax year -- § 179 allows TP to deduct currently the cost of acquisition of certain depreciable business assets
 - § 179 is elective
 - § 179 property is generally tangible personal property acquired by purchase for use in the active conduct of a trade or business
 - Limit on the amount that can be deducted under § 179 w/ respected to qualifying property placed in service during a year
 - 2001 or 2002\$24,000
 - 2003 or after \$25,000
 - Another provision allows for absolute deductions – express override of § 163 to deduct what would otherwise be capital expenditures
 - § 197: authorizes amortization of goodwill, going concern value, covenants not to compete, and a broad range of other business intangibles
- 3. Losses (§ 165 & 267)**
 - § 165 authorizes a deduction for any uncompensated loss sustained during the year – loss deduction for individuals to trade or business losses, losses in profit – seeking transaction, and casualty or theft losses
 - Personal expenditures are not deductible
 - Activities that constitute a trade or biz for § 162 purposes should do the same when the focus shifts to § 165
 - Profit seeking aspect is most litigated
 - TP primary purpose is controlling
 - Exceedingly doubtful that profit – motive will be considered dominant when the TP is making personal use of residential property but if property is actually used at times for personal purposes and at other times for biz or profit – seeking purposes, then allocation of a loss between the

nondeductible personal use and deductible business or profit – seeking use is allowable

- Loss must be evidenced by closed & completed transactions -- usually a sale or exchange of property
- Theft losses are treated as sustained in the year the theft loss is discovered
- Amount of loss deduction is limited by § 165 (b) to adjusted basis as computed in 1011
- To extent that TP receives insurance or other compensation, the loss is offset & the deduction reduced –
- § 267
 - § 267(a)(1) disallows losses on related party sales or exchanges
 - § 267 (c)(4) defines related individuals for this purpose as brothers & sisters (whether half or whole), spouse, ancestors, and lineal descendants
 - If you sell item to a family member than no loss but when the family member sell it her basis is reduced by the amount of your loss so she gets a gain if she sells it at a gain (see syll prob)
 - Why: transaction b/w family members and low price is might be like a gift so bright line rule

4. Bad Debts (§ 166)

- Allows deduction for bona fide debt that becomes worthless w/in taxable year
 - Bona fide debt = debtor/creditor relationship based on a valid, enforceable obligation to pay a fixed or determinable sum of money
 - Family debts are scrutinized closely and b/w related parties → rebuttable presumption that it was a gift and not a debt
 - Worthless is not proven by debt forgiveness or cancellation
- Business bad debt
 - Entire debt can be deducted as loss in year it becomes worthless
 - If only partially worthless, it can be partially written off
 - Regs. provide that no bad debt deduction is allowed unless such amounts have been
 - Amount of a bad debt deduction is the debt's adjusted basis & no bad debt deduction is allowed unless such amounts have been included in income
- Non – business bad debt
 - If non – business it treated as a capital loss
 - 166(d)(2): defines non-biz debt as a debt other than one created or acquired in connection with TP biz, or a debt the loss from the worthlessness of which is incurred in the TP business
 - Test: look at dominant motivation of TP when \$ was advanced or loaned – if loaning \$ was designed to protect one's investment interest = non-business BUT protecting one's salary = business interest (see US v. Generes)

VII. Distinction between Deductible Business or Investment Expenses and Non-deductible Personal, Living, or Family Expenses

1. Local Travel & Commuting

- Under § 262 no deduction for personal living or family expenses
- Choice of where one lives is generally personal – so commuting costs are generally not allowed
- TP may deduct travel when conditions or employment restrict modes of commuting (i.e. 2 police officers forced to use their personal vehicles all the time for police work)
- Revenue Ruling 99-7
 - Costs of going b/w one business location & another biz location are generally deductible
 - Daily transportation expenses are not deductible when paid or incurred by the TP in going to temporary work site inside metro area but transportation expenses are deductible when paid or incurred in going between the TP residence and temporary work site outside that metro area
 - TP with one or more regular places of biz, daily transportation expenses paid or incurred in going between the TP residence and temporary work locations are deductible regardless of the distance
 - If TP residence is TP principal place of business than TP may deduct daily transportation expenses incurred in going between the residence and another work location in the same trade or biz, regardless of whether the other work location is regular or temporary and regardless of the distance
- 2. Food & Lodging: Away from home**
 - 3 conditions for traveling expense deduction (Flowers & 162(a)(2)):
 1. It must be reasonable & necessary
 2. It must be incurred away from home
 3. It must be incurred in the pursuit of business
 - Direct connection b/w expenditure and carrying on of the trade or biz of TP or of his employer
 - § 162(a)(2): provides for travel away from home as deductible biz expense –
 - a. Does it require you to sleep/rest somewhere else?
 - b. Duplicate expenses (still paying for other residence)
 - c. Incurred in pursuit of business
 - d. Reasonable expenses
 - Where primary purpose for travel (i.e. air travel) is business you will be entitled to deduct the transportation costs which are business related BUT if trip is primarily personal in nature, the transportation expenses are not deductible, although any expenses incurred while at the destination that are allocable to TP trade or biz are deductible.
 - Special treatment for TP in temporary (year or less jobs) → travel expenses paid in connection with the temporary assignment away from home are deductible
 - Travel Expenses of a Spouse
 1. Spouse, dependent must be bona fide employee of TP
 2. Travel of spouse is for bona fide biz purpose
 3. Spouse or dependent could otherwise deduct the expense
 - Reimbursed employee expenses (accountable plan)
 1. Reimbursement arrangement must be only for deductible business expenses
 2. Expense must be properly substantiated (i.e. have receipts for everything)

3. Reimbursement arrangement must require the e'ee to return within a reasonable time any amount in excess of the substantiated expenses

3. Entertainment & Business Meals

- Almost every business meal & entertainment event has a personal element
- Very hard to determine on an objective basis whether event is business or personal
- Moss v. Commissioner – small law firm w/ lots of biz and mostly all in court so met at lunchtime
 - Ct. says they would have eaten lunch anyway so = personal expense
 - No special business reason to have lunch together
- Questions to ask:
 1. Is it really business?
 2. Even if it's really business should you limit extent to which people are deducting income?
 - § 274: does not authorize deductions – deduction is allowed under § 162 & § 274 is a limitation on those ordinary & necessary expenses of § 162
 - Regs define what constitutes entertainment (e.g. plays, sporting events, etc.)
- Taxpayer must satisfy one of two tests:
 1. TP must est. expenditure was directly related to active conduct of TP trade or biz
 - Must be more than a general expectation that business will be generated at some future date
 - During entertainment period some business discussion must actually take place
 - On balance it must be predominantly business
 2. Entertainment must be associated with active conduct of trade or biz
 - Entertainment immediately precedes or follows a bona fide business discussion
- § 274 (d) – requires substantiation or a paper record of amt. of expense, time, & place, business purpose & business relationship
- § 274 (k)- subject to a number of exceptions when dealing with food or beverages:
 - no deduction allowed for lavish & extravagant and
 - if TP is not present
- §274 (n) – only 50% of meals & entertainment are allowed as deduction if meet § 162 test

4. Education

- Individual may deduct educational expenses that either: (Regs § 1.162-5a)
 1. Maintain or improve skills required in his employment or trade or business
 - Refresher courses or courses dealing w/ current developments as well as academic or vocational courses fall w/I this category
 - TP must be established in trade or biz before any expenses are deductible
 - Suspension of employment for a year or less is temporary and if TP has abandoned or w/drawn from that trade or biz when educational expense are incurred

2. Meet the express requirements of his employer, or applicable law, necessary to retain his established employment relationship BUT
 - Requirements must be express and the regulations go on to impose additional requirements
 - Must be for a bona fide business purpose
 - Only the minimum education necessary to retention of job, status, or pay will qualify – education beyond the minimum may, however, satisfy the skill maintenance test.
 - An expense is non deductible (even though it may satisfy the skill – maintenance or employer requirement test) if it either:
 1. Meets the minimum educational requirements for qualification in the TP employment or trade or biz
 - Generally undergrad study not deductible b/c generally increases one's personal worth nor law school – still considered a minimum requirement for most jobs
 2. Qualifies the TP for a new trade or biz
 - Mere change of duties does not = new trade or biz
 - Hope Scholarship Credit
 - Allows fed. gov't to pick up cost of community college → available for 1st 2 years of post secondary education
 - Tax credit that allows 100% of 1st 1000 spend on tuition
 - Tax credit = dollar for dollar tax savings vs. a deduction
 - Credit is phased out based on income
 - Lifetime Learning Credit
 - Tax credit = 20% of 1st 10,000 paid for qualified tuition expenses & related expenses
 - Credit is available with income limits
 - § 222 – another provision designed to help middle income families pay for college costs
 - Allows a TP deduction for up to certain amt. of education costs if fall into certain income categories
 - § 529 – Saving for education (see h/o)
 - Under § 529 a plan can be est. where TP can invest \$ & interest is not taxable IF funds are w/drawn to pay educational costs
 - Educational stuff has nothing to do with determination of income
- 4. Child care expenses § 21 (see Childcare Credit h/o)**
- A credit allowed for a specified percentage of child care expenses up to a maximum dollar amount
 - Percentage = 35% reduced to 20% as income increases from 15,000 to 45,000 (i.e if the TP AGI is b/w 15,001 and 17,000, the percentage is reduced to 34% and so on)
 - Expenditures counted up to \$3000 for one kid; \$6000 for two or more kids
 - Expenses must be incurred to enable TP to be gainfully employed
 - Expenses must be for the care of a qualified individual – which generally is a dependent who is less than 13 years of age (§ 21(b))

- Expenditure cannot exceed earned income of the lesser earning spouse; however full time student is deemed to earn enough to qualify the credit for each month that the student is a full time student
- 5. Legal Expenses (Reg 1.262 -1 (b)(7))**
- To distinguish b/w deductible & non-deductible legal expenses → SC has applied an “origin of the claim test”
 - If origin of the claim litigated lies in a personal, as opposed to a business or profit seeking transaction, the expenses are nondeductible
 - Most legal expenses incurred by a corporation are ordinary & necessary business expenses
 - Regs permit a deduction for fees & costs properly attributable to the production or collection of alimony
 - In subsequent litigation, the TP was permitted to add legal expenses that were incurred in the divorce to the basis of the property in question on theory that defense of title are capital expenditures regardless
 - Legal expenses, even if business related, are subject to the capital expenditure rule of § 263
- 6. Clothing Expenses**
- Test of deductibility of clothing:
 - a. Type specifically required as condition of employment
 - b. Not adaptable for general use
 - Adaptability for personal or general use depends upon what is generally accepted for ordinary street wear
 - c. And not worn for general use
 - To satisfy test it must not be suitable and not used – if used for general use than it becomes just clothing
 - Deductible the uniform acquisition and maintenance costs for PO, firemen, letter carriers, nurses, bus drivers & others required to wear distinctive types of uniforms while at work ... which are not suitable for ordinary wear

VIII. Personal Deductions

1. Standard Deduction & The Personal Exemption (§ 63 & § 151)

- Notwithstanding § 262 disallowance for personal expenses the tax code has several provisions that allow for things that are clearly personal
- Vertical equity – people w/ moderate & low income should not pay income tax
- Personal exemption allows TP to deduct 3,050 per person (§ 151)
- Standard deduction: modest amount that represents expenses of life & is income dependent – taken instead of itemized deductions
 - Look to § 63 to know when to itemize & when to take standard deduction
 - § 63 (b): in computing tax liability if you don’t itemize deductions than taxable income = AGI – standard deduction & deduction for personal exemption in § 151 and (for people with kids -- tax credit § 24)
- § 68 (f): reduction of itemized deduction for high income TP

2. Earned Income Tax Credit (§ 32)

- Largest anti-poverty legislation congress administers
- Refundable credit – if amount of credit exceeds tax liability -- IRS will cut you a check (negative income tax) → Why has congress implemented this?
- 1. Calculated w/ reference to earned income of TP
 - To get this benefit TP must have a job
- 2. Designed to reduce tax burden on working poor
- § 32 – people eligible for EIC
- a. Individual who has a qualifying child → kid must have same place of abode as person seeking credit
 - Kid must be under 19 unless full time student
 - People unmarried w/ no children b/w ages 25-65 may get modest EIC
 - People w/ children = EIC = % of specified amount of earnings & depending on # of kids
 - For families of modest income = significant benefit
- EIC only provision that gives certain TP reason to fraudulently claim more income b/c get bigger tax credit
- EIC eliminated as people's income level goes higher
- Congress has directed IRS to audit a much higher percentage of EIC recipients b/c very suspicious of cheating more than t/o tax law
- All this stuff eliminates income tax for close to 1/2 the population

3. Personalized Itemized Deductions

- A. Interest Deduction (§ 163)
- Allows deduction for interest paid in taxable year on indebtedness
 - Congress has expressed concerns over:
 - a. Whether something is really interest
 - b. Whether they mean to allow all interest to be deductible
 - c. Whether it's really paid or accrued
 - In general TP cannot deduct personal interest expenses unless provision that allows it (home mortgages & student loans)
 - Interest = amount paid for use of \$
 - a. Must be a true loan in existence w/ real interest rate
 - Doesn't matter who you borrow from but scrutinize interest closely b/w related parties
 - A cash basis borrower is not entitled to an interest deduction where the funds used to satisfy the interest obligation were borrowed for that purpose from the same lender to whom the interest was owed (Davis v. Commissioner)
 - Ct. looked at whether substance of transaction was consistent with form put forward by TP – Was TP really any different from payment of interest? No
 - If TP had borrowed from an outside source to pay than that would be considered deductible interest payment b/c parties would be in different positions
 - b. Is the payment made by the person who has obligation to pay? e.g. pay for daughter
 - c. Has interest really been paid or accrued during the year?
 - d. Any limitations preventing TP from deducting interest? Sec. 163(h)

- No deductions for personal interest pd. or accrued during the year
- § 163 (h)(2) – Inappropriate to allow deduction for all forms of personal interest w/ certain exceptions:
 - Interest on indebtedness allocable to trade or biz
 - Investment interest
 - Any qualified residence interest – defined in § 163(h)(3)
 - Acquisition indebtedness OR
 - Indebtedness in acquiring, constructing, or substantially improving any qualified residence AND
 - Secured by such residence (e.g. there is a mortgage recorded in books & evidence of bona fide loan)
 - Maximum dollar amount = 1 million dollars
 - Home Equity indebtedness
 - Indebtedness other than acquisition secured by a qualified residence
 - Qualified residence = 1) Principal residence of TP and 2) 1 other residence by TP used as a residence
 - Why did Congress allow these exceptions? At 1st they wanted to encourage home ownership & stability
 - Than it would have caused values of home to be lowered
- B. Taxes
- C. Casualty & Theft Losses (§ 165)
 - § 165 (c)(3): authorizes a deduction for an individual's uncompensated casualty and theft losses that are unconnected w/ a trade or business or with a transaction entered into for profit
 - Net casualty loss for the year is determined after the application of the \$ 100 floor (amount of loss must exceed \$100 & 1st 100 of loss is TP to suffer personally) & is allowed to extent it exceeds 10% of TP AGI
 - Casualty loss = losses for fire, storm, shipwreck, or other casualty or from theft
 - Must be sudden change in value
 - Must be direct physical effect on the property w/ Finnecker case exception (flood caused damage to houses all around and abandonment of property even though no damage to their house – they were allowed to deduct b/c caused by flood which is sudden)
 - If slow erosion underneath (e.g. termites) had taken place gradually than no deduction
 - If TP gets insurance than take into account ins. pd
 - § 165 (e)(3): TP is required to file an ins. claim if he has insurance to fall into statute
 - A casualty loss is deductible in the year sustained whereas a theft loss is deductible in the year discovered
 - If there exist a claim for reimbursement with a reasonable prospect fro recovery, allowance of the loss awaits the resolution of the claim with reasonable certainty
 - Amount of casualty loss is lesser of:
 1. Adjusted basis of the property AND

2. The difference b/w the FMV of the property beforehand and the FMV afterwards – that is the amount of the decline in value
- D. Medical Expenses (§ 213)
- § 213(a) allows deduction for medical expenses – amt. of insurance & to extent that such expenses exceed 7.5% of income
 - Deduction allowed only for expenses actually paid during the year
 - § 213 (d) defines medical care as → for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body
 - If Dr. prescribes preventative meds...qualifies as medical care, certain drugs that are not prescription but used to be (e.g. Claritin) are still deductible.
 - For a deductible diet (§ 213 does not require least cost alternative) show:
 1. Diet is medically prescribed
 2. Cost of new diet → higher than ordinary costs
 - Ordinary diet = personal expense = non- deductible
 - Regs: deductions limited to expenses incurred primarily to alleviate physical or mental defects or illness, and will not extend to expenses that are merely beneficial to . . . general health
 - § 213 (d)(9): Generally term medical care does not include cosmetic surgery UNLESS necessary to ameliorate a congenital deformity or one arising from a personal injury resulting from accident, or trauma, or disfiguring disease
 - Transportation expenses are deductible if incurred primarily for & essential to medical care
 - § 162(l): For self employed individuals → allowed a deduction an amount equal to the applicable percentage of the amount paid during the taxable year for insurance which constitutes medical care for the TP, his spouse, and his dependents.
- E. Charitable Contributions (§ 170)
- There is no deduction for the value of one's services given to charity BUT
 - you may deduct value of things you buy on behalf of charity
 - Contributions must be made to a charitable organization that has 501(c)(3) status
 - To qualify as a deductible charitable transfer must"
 1. Be made to or for the use of a qualified recipient
 - Qualified recipient= organized and operated exclusively for religious, charitable, or other specified purposes, its net earnings cannot inure to the benefit of any private sholder or individual and its lobbying & political activities must be limited
 - In no event is an individual a qualified recipient
 2. Constitute a transfer of money or property made with no expectation of a return benefit
 - Donor/Transferor's intent is controlling in determining whether or not gift was made
 - Contribution= voluntary transfer of money or property that is made with no expectation of procuring a financial benefit commensurate with the amount of the transfer

- Contribution is made at the time delivery is effected & unconditional delivery or mailing a check which subsequently clears in due course will constitute delivery on date of mailing.
- 3. Actually be paid to the recipient; and
- 4. Not exceed certain percentage limitations
 - Contribution cannot exceed 50% of AGI
 - Charitable contributions that may not be currently deducted b/c of percentage limitations may be carried over for a 5 year period.
- Questions to ask:
 1. Was a contribution really made?
 2. Are there rules that limit deduction amt. when property vs. cash is donated?
- Rule: When a contribution is made & you get something back (i.e. free tix to all founders day events) than contribution deduction is reduced by amt. you got back BUT thing conferred upon you an extra benefit (e.g. if I would have gotten the tix free anyway by virtue of being a student than I have not really received an extra benefit)
 - To the extent that you get a performance that is for charity you may deduct it – less than amt. you would have paid for ticket of concert otherwise
 - Charitable organizations must issue receipt for contributions over \$250.00 and specify whether or not TP rec'd a benefit from contribution
- General rule concerning contributions of property is that contribution is = to FMV BUT
 - § 170(e)(1) limits the deduction in certain instances: Amount of any charitable contribution of property shall be reduced by the sum of (applies to appreciated property only)
 - a. The amount of gain which would not have been long term capital gain (short term= owned less than a year) if the property contributed had been sold by the TP at FMV AND
 - b. In the case of a charitable contribution –
 - i. of tangible, personal property, if use unrelated to exempt purpose OR to
 - ii. to or for use of private foundation
 - That amount of gain which would have been long term capital gain if the property contributed had been sold by the TP at FMV (determined at the time of such contribution) – see example in notes for a better understanding

IX. Limitations on Deductions, Losses & Expenses

1. Requirement of a profit-seeking activity (Hobby losses) (§ 183)

- § 183 looks at TP attempts to deduct inappropriate things
- Limitation in this section kicks in where TP has not engaged in activity for profit
- Enacted to deal with TP who were claiming that hobbies = trade or business
- General rule – no deduction allowed unless engaged in activity for profit BUT
 - If activity not engaged for profit – still allowed to deduct certain ones (e.g. charitable contributions, casualty loss, medical expenses, home-interest mortgages), etc. – these are not disallowed just because not profit seeking.
 - § b(2) also delineates other allowable deductions (see example on syllabus for better understanding) : there shall be allowed a deduction equal to the amount

of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1)

- Basically allows 3 categories of deductions:
 1. Home mortgage interests, etc.
 2. Deductions that do not result in basis adjustment and that would otherwise be allowable if activity were engaged in for profit --- Category 2 deductions must be taken before Category 3 deductions
 3. Deductions, such as depreciation, that result in a basis adjustment and that would be allowed if activity were engaged in for profit
 - Cat. 3 deductions are only allowed to the extent the gross income from the activity exceeds the combined total of cat. 1 & 2 deductions
- Each activity must be tested separately as to whether or not it was engaged in for profit
 - Regs flesh out nine relevant factors for determining whether activity is engaged in for profit
 1. Manner in which TP carries on the activity
 2. Expertise of the TP or his advisors
 3. Time and effort expended by the TP in carrying on the activity
 4. The expectation that assets used in the activity may appreciate in value
 5. The success of the TP in carrying on other similar or dissimilar activities
 6. TP history of income or losses w/ respect to the activity
 7. Amount of occasional profits, if any, which are earned
 8. The financial status of the TP
 9. The elements of personal pleasure or recreation
 - Legal standard (*Dreicer v. Commissioner*): whether the TP engaged in the activity with the objective of making a profit, not whether he had reasonable expectation of making a profit
 - Ct. says you need to look at surrounding circumstances to decide TP intention
 1. Large losses in 1st few years? Not determinative
 2. No realistic possibility of profit?
 3. Able to bear the losses b/c of other resources?
 4. Conducted in a business like manner? (i.e. trying to keep costs down)

2. Home Office Expenditures & Vacation Homes (§ 280A)

- § 280A deals with situation where 162 could allow too broad of a deduction so this limits it.
 - b/f 280A enacted a lot of people claimed that home office was deductible
- General rule: no deduction allowed w/ respect to dwelling unit used as a residence – elements:
 1. Is it a dwelling unit? (house, apt, etc.)
 2. Is it being used as a residence?
 - Residence is defined in § 280A(d): as used for personal purposes for a number of days which exceeds the greater of
 - a. 14 days

- b. 10% of the number of days during such year for which such unit is rented at fair rental
 - So unless exceptions kick in – can't deduct a home office
- § 280A(b): disallowance does not apply to deductions already allowed that are not connected to trade or business (e.g. interest – mortgage, real-estate taxes, etc.)
- § 280A(c): Exceptions for certain business – if person uses house as principal place of business may deduct costs BUT only applies if
 - a. exclusively used
 - b. on a regular basis
 - If person is e'ee than only applies if exclusive use referred to in preceding sentence is for the convenience of e'er (i.e. if you have an office at work, can't deduct home office b/c more convenient for you to work at home)
- Case law factors (Popov. Commissioner) – to determine whether principal palce of business look at:
 1. How much time spent
 2. Relative importance of what she did at home vs. elsewhere
 - Principal place of business also = § 280(c): place used for administrative or management activities
- Vacation home deductions
 - If TP rents out but uses more than 14 days or 10% of time rented than limitation on rental deduction
 - Deductions attributable to the rental may not be claimed in excess of the amount by which the gross income derived from the rental activity exceeds the deductions otherwise allowable w/o regard to such rental activity (e.g. mortgage interst & real estate taxes)
 - § 280(e)(1): provides that portion of expenses (insurance, depreciation, utilities, etc.) allocable to rental activities is limited to an amount determined on the basis of the ration of time the home is actually rented for a fair value to the total time that the vacation home is used during the taxable year for all purposes including rental.

X. Tax Accounting: When is it income or deductible?

1. Income under the Cash Method of Accounting

- Cash method requires TP to report cash as rec'd and deduct expenses as they are paid
- Reciept and Disbursement are the critical events
- Reg 1.446-1: Under cash method: all items which constitute gross income (whether in the form of cash, property or services) are to be included for the taxable year in which actually or constructively received
- Doctrine of Constructive Receipt: income, although not actually reduced to TP possession, is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to w/draw had been given -- Income is not constructively received if the TP control of receipt of income is subject to substantial limitation & restrictions

- TP cannot turn his back on income & TP who has control must report it whether or not he has actual physical possession (e.g. if the paycheck is there in the office for you to pick up but you don't pick up still = constructive receipt)
- 2 requirements:
 1. The amount must be available to TP
 2. The TP control over receipt must not be subject to substantial restrictions or limitations
- Generally date when check is received and not when mailed that determines year of taxation
- If TP does not know the check is available than it does not = constructive receipt
- If a rental payment is not due until Jan. 1 but T tries to pay Dec. 31, L is not required to accept before that time
- Payment with borrowed funds constitutes payment for tax purposes
- Payment takes place when check is delivered even though TP has power to stop check, provided check clears
- Issuance of one's own promissory note does not = payment
- Doctrine will look at legal and practical restrictions to your \$ -- Did you have unfettered control of your \$
- Deferred Compensation Arrangements – NEED CLARITY ASK ABOUT THIS
- 2. Deductions under the Cash Method**
- Expenses are deductible when paid
- Under cash method, contribution must be made b4 Jan. 1 to count towards 2003 and once \$ in mailbox it is considered paid as to the cash method TP—it can be deducted if mailed on or before 12/31/03
- A mere deposit of funds by a cash basis TP as an offer in compromise of a disputed amount is not deductible when deposited, but instead the deduction awaits acceptance of the offer
- When a deduction is made with borrowed money, the deduction is not postponed until the year in which the borrowed money is repaid. . . such expenses must be deducted in the year they are paid and not when the loans are repaid
- 3. The Accrual Method of Accounting**
- Under accrual method – earning of income vs. receipt of it = critical event for inclusion & fixing of obligation to pay = critical event for deduction
- All events test from Regs:
 - a. An item of income is includable in gross income when all events have occurred which fix the right to such income & the amount thereof can be determined with reasonable accuracy
 - b. An expense is deductible when all the events occur which establish the fact of liability, the amount can be determined with reasonable accuracy , and economic performance has occurred with respect to the liability
- Looks at when TP has rights & obligations
 - TP has income when they have unrestricted right to receive pmt even if pmt does not come

- TP entitled to deduction in year when TP obligation to make pmt. becomes fixed
- Look at contractual relationships b/w parties to see when pmt. is due & when pmt. becomes obligated. (e.g. if furniture delivered and it says pmt. due upon delivery, pmt. fixed at that moment)
- See HYPO in notes
- Obligation does not become fixed until property sold
- Amount & fact of obligation must be known to reasonable certainty
- Generally a contested liability cannot be deducted by an accrual method TP b/c the contest, in effect, renders the liability contingent and prevents it from being fixed or established
 - § 461(f): provides in general that payment of a contested liability accrues the liability and provides a current deduction in the year of payment.
- Most businesses of substantial size select accrual method & once an accounting method is selected it may not be changed w/o Commissioner consent.

XI. Introduction to Capital Asset Transactions

1. Statutory History & Policy

- Pro's & Cons of preferential capital gains treatment
 - P: Gain realized on sale/exchange of capital asset is often largely due to inflation and does not represent any real increase in the value of asset and reduced rate of tax therefore negates imposition of tax on illusory gains
 - P: argue that mobility of capital impaired if capital gains taxed like any other income
 - P: If tax like all other income = disincentive to saving
 - P: Encourages investing and differentiating b/w long term & short term encourages people not to move in & out too quickly
 - C: creates need for complex statutory provisions
 - C: it's income – should not be taxed differently
 - C: Capital gains are concentrated among wealthy people anyway

2. Current Statutory Provisions (§ 1221, 1202 & 1h)

- For purposes of our course we can always assume that there is 1 transaction (don't have to look at long term vs. short term) w/I the year
- Important thing to remember = 5% & 15%
- Rich folks in 35% income bracket – capital gains tax at no more than 15%
- Modest income – capital gains tax at no more than 5%
- Low income – 0% tax on capital gains
- Gain on certain collectibles taxed at 28% rate (§ 1h5)
 - Collectible = baseball cards, paintings, antiques, etc.
 - Congress has decided that investments in those things should not be valued as investments in stock
- Section 1250 gain taxed at 25%

3. Limitation on the Deduction of Capital Losses (§ 1211)

- Capital loss treatment is harsh for TP -- § 165 states that capital loss shall be deductible only to extent allowed by § 1211 & § 1212
- 2 rules in § 1211
- 1. Corporation – capital losses deductible ONLY to extent of capital gain

2. Individual – capital losses can offset capital gains + 3000 of other income (see example in notes)
 - § 1212 allows net capital losses that is not allowed to be deducted in previous years to be treated as capital loss for the next years until it's gone
- 4. Definition of Capital Assets § 1221**
 - § 1222 – only long term gains (held for over a year) get benefits of low rates
 - § 1221(a): Capital asset = property held by the taxpayer (whether or not in connection with trade or biz) but DOES NOT include:
 1. Inventory, stock in trade, and property held primarily for sale to customer in the ordinary course of TP trade or biz
 2. Property, used in trade or biz, of a character which is subject to allowance for depreciation or real property used in trade or biz
 3. Copyright held by TP who created that property or TP in whose hands the basis of such property is determined (i.e. if person who created it gave it you as a gift so you have their basis than not a capital asset) BUT if sell it & person you sold it to sells it, to him it's a capital asset b/c he did not create it with his own hands.
 - a. Inventory & Property held for Sale to Customers
 - Primarily held for sale = of first importance
 - More often you sell similar property – more likely it looks like ordinary course of business
 - Instances of real property – passive ownership of property that appreciates with no effort of TP – if not held for sale in ordinary course of biz = capital asset
 - If get zoning approval which increases value of property is it still a capital asset – more activities you do to make it valuable the more likely it is that it does not = a capital asset
 - See pg. 709 exercise on which is a capital asset
 - b. Other Assets excluded from capital asset treatment
 - Accounts Receivable for services rendered or inventory type assets sold
 - Certain publications of the US Government
 - Supplies used or consumed in TP trade or biz
- 5. Quasi Capital Assets (§ 1231)**
 - § 1231 asset treatment = best of both worlds – provides for special treatment from gain or loss from depreciable property excluded from capital asset treatment of § 1221(a)(2) – (See Examples 1 & 2 in the book)
 - § 1231 says gain from sale of asset that fall in this section is treated as long term capital gain but losses are treated as ordinary loss
 - § 1231 is a characterization provision; it comes into play to characterize certain gains & losses that are otherwise realized & recognized under the code.
 - § 1231 applies to two categories:
 1. Applies to the sale or exchange of property used in trade or biz –
 - This property must be depreciable or real property used in trade or biz (Thus definition embraces property which is excluded from capital asset classification under § 1221(2))
 - The property must have been held more than one year (i.e. long term capital gain)

- The property must not fall w/I any of the other § 1221 exclusions from capital asset classifications
2. Involuntary or Compulsory Conversions of 2 types of property:
- a. Property used in trade or biz
 - Defined in § 1231 to exclude property held by TP primarily for sale to customers in ordinary course of biz
 - b. Capital assets held for more than 1 year in connection with trade or biz or a transaction entered into for profit
 - If § 1231 gains exceed § 1231 losses than all gains and losses become long term capital gains and losses – if not than all gains & losses are ordinary
 - Gains & losses in involuntary conversions are not subject to § 1231 at all if total involuntary losses exceed total involuntary gains
- 6. Recaptures of Prior Depreciation Deductions**
- See Recapture handout
 - § 1231 tells us what happens if tax code underestimates amt. of depreciation
 - § 1250/1245 recapture is where IRC has overestimated depreciation & basis TP has is artificially low & when asset is sold it's gain is attributable to the mistake NOT capital gain
 - § 1245 only applies to depreciable personal property NOT w/ depreciation that applies to real property (that is covered by § 1250)
 - § 1250
 - Gain from disposition of certain depreciable real property acquired prior to 1986 – after 1986 amt. treated as 0
 - § 1(h)(d): TP has capital gains will be taxed at rates for unrecaptured § 1250 gain at 25% rate
 - Unrecaptured gain defined in § 1(h)(6): as either
 - Total amount of gain on disposition of real property OR
 - If less -- than total amount of gain (same composition as 1245 recapture)
 - § 1245 causes gain to be treated as ordinary income but § 1250 gain taxed at 25% tax rate but analysis is the same for both
- 7. Transactions Involving Liabilities & Property subject to liabilities**
- Generally → Receipt of borrowed funds does not = income b/c no net increase in income & repayments of loans do not = deductible expenditures
 - TP basis in newly acquired property usually = cost & it does not matter how he finances it (whether through own money or through loans)
 - If someone else pays off your mortgage – characterized as if cash was paid to you and than you paid mortgage (In Crane – ct. treats this as sale of property)
 - If loan is forgiven by creditor than § 108 treats amount forgiven as income
 - Non – recourse debt: debtor is not personally liable for loan – lender would have to foreclose to get loan \$
 - Typically we borrow on recourse basis – if we don't pay than lender can go after all our collateral pledged, assets, garnish wages, etc.
 - Non-recourse usually incurred w/ acquisition of property & lender's only recourse for non-payment is to go after that property
 - Crane & Tufts examine whether principles of borrowing should apply in non recourse situations (see Crane & Tufts h/o for how to the numbers)

- Crane: holding = buyer has to include non-recourse debt in basis when they acquire & sell property in their gain
- Why? Buyer got a tax benefite from being able to claim depreciation early so this appropriate
- Rationale: During relevant history she's pad tax on appropriate amount of income until disposition
- When TP acquires property w/ non-recourse debt → basis = what they paid & when TP sells → gain = nonrecourse debt + cash rec'd
 - In Crane had to decide whether or not gain was capital
 - Under § 1221 since it was rental property used in trade or biz No But
 - Under § 1231 = quasi capital gain so gain is capital gain but losses = ordinary income
- Crane enable other provisions to work in terms of income characterization
- Crane has famous FN 37 – S.Ct. says result applies when FMV at time disposition exceeds non-recourse debt assumed by TP
- Assumes that TP will take excess and be able to pay off debt
- Tufts
 - In Tufts – FMV DID not exceed indebtedness
 - Decline in Tufts bigger than depreciation taken (inadequate depreciation) – judicial recapture rules – see h/o on Tufts for better understanding along w/ explanation in notes

XII. Tax Consequences of Divorce

1. Alimony & Child Support Payments (§ 71)

- § 71(a): amounts received as alimony or separate maintenance payments are includable as gross income
- Alimony is designed to substitute resources to maintain standard of living
- Payor of alimony may also deduct amt. pd in computing adj. gross income
 - These amt. can be deducted even if TP doesn't itemize – every TP who makes pmt can deduct
 - No limits imposed on amt. deducted and no phase out as income increases
 - Very straightforward
- 2 questions to ask:
 1. How distinguish alimony from child support?
 - Child support is NOT deductible – true even if non-custodial parent who makes pmt. to custodial parent for support of child
 2. How treat amt. of property settlements/division of assets at dissolution of marriage?
 - To qualify as alimony:
 1. The payment must be in cash
 - If property transfer occurs pursuant to a divorce – see § 1041 – incident to divorce so treated as a gift
 2. The payment must be received by or on behalf of spouse (or former spouse)
 3. The payment must be made under a divorce or separation instrument
 - Must be an agreement to be divorce/separation instrument
 - If spouse pays something not included in separation instrument than it is not deductible

4. If separated – can't be members of the same household at time pmt. is made
5. The payor spouse must have no obligation to make payments for any period after death of payee spouse

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