ADVANCED INDIVIDUAL TAXATION

Business 225K – Fall 2011

Online Course

Professor Annette Nellen

Online (at student pace, but with some specified due dates)	September 16 to December 9, 2011
Optional face-to-face meeting	Sat. 10/29 from 2 – 3:30 on main campus BT 550
Office hours	By appointment + available by email
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Internet	http://www.cob.sjsu.edu/nellen_a/

Course objectives: To gain a deep understanding of the rules on passive activity loss limitation, interest categorization and limitations, individual alternative minimum tax, and individual net operating losses. You will learn the rationale behind these rules, how they interact with other tax provisions, traps, planning opportunities and proposed changes. Rules on self-employment tax, vacation and home office rules, hobby loss, at-risk and flow-through entity rules will also be covered as relevant to passive activity, interest expense, NOL and AMT matters.

The class is designed to give you an opportunity to hone your skills in finding, reading, interpreting and applying the tax law. We will study the IRC provisions along with the legislative histories, regulations and other guidance. From this we will create flowcharts on how the rules work, cautions in dealing with the rules, and identify planning opportunities.

Texts

- Internal Revenue Code (see 225K website)
- Income Tax Regulations tied to IRC sections we'll cover (§§469-X, 1.163-8T, 1.163-9T, 1.163-10T, 172, 53 - 59) You can obtain the regs from RIA Checkpoint or CCH; the §163 regs are on the 225K website.
- Reading materials assembled by Professor Nellen and available from the BUS 225K web site:

  http://www.cob.sjsu.edu/nellen_a/ClassInfo.html

Grading

Research / application exercises	76
Quizzes (online) (7 @ 10 points each)*	70
Presentation	24
Final Exam (online)	100
Total	270

Grades will be assigned based on 90% and above is an A, 80% and above a B and 70% and above is a C, etc. Plus and minus (+/-) will be used as well.

* see Desire2Learn for due dates

Reading and Assignment Due Dates

Presentation (DUE by 11/19/11) (24 points)

You will create a video on a rule or case you sign up for (everyone has a different topic). You will use Brainshark to make the video (some of you have used this in other classes before). Details:

- Length – 4 – 6 minutes (so 4 to 7 slides) (any of these topics could be much longer presentations, so you need to hit the highlights in your short video)
- Purpose – explain the rule or case such that your fellow tax practitioners can understand the law, its importance, what type of clients would be affected by the topic. Examples are a good idea, as are referencing the pertinent law.
- Be sure your explanations are clear, the narration and slides are engaging, and correctly explain the law.

Your video will be posted to the course website to be viewed by your fellow students. These videos will also help to review for the final exam.

Topics to select from:

A. Section 469 ruling – *Schwalbach*, 111 TC 215 (1998)

B. Section 469 ruling - TAM 201035016

C. Section 369 ruling - *Bruce Bailey, et ux.*, TC Memo 2001-296

D. Home office deduction

E. American Opportunity Tax Credit

F. Kiddie Tax

G. Alimony and child support payments

H. Charitable contribution of cash and used clothes

I. Charitable contribution of stock (whether appreciated or not)

J. "Donation" to enter a charitable organization's raffle (see Rev. Rul. 67-246, Patterson, TC Memo 1987-252 and other pertinent guidance)

K. Charitable contribution of a painting likely worth $65,000 by single taxpayer with AGI of $400,000; what documentation and reporting is required and how much is deductible

L. Donation of an individual's used auto to a charity (like you have likely seen ads for on television and billboards)

M. Casualty loss involving a car destroyed in an accident

N. Medical deduction

O. Miscellaneous itemized deductions

P. Hobby loss rules of §183

Q. Treatment of gambling winnings and losses by someone who is not a professional gambler

R. Estimated tax payments for individuals – how to calculate and penalty for not paying timely

S. Tax treatment of US Savings Bonds (in general) + special rule at §135

T. Federal and California income tax reporting for California registered domestic partners

Reading and Instructor Presentations

The table below lists the sequence of topics. These topics will be covered through a combination of reading (mostly primary authorities), online video presentations with accompanying Powerpoint files you can download (and print if you wish), quizzes on the video presentations, research/application questions, and a project where you explain a particular individual provision and provide examples and planning ideas for it (the "newsletter" project).

The reading materials and videos/Powerpoint files can be found here - http://www.cob.sjsu.edu/nellen_a/ClassInfo.html#225K

The quizzes and final exam is at your Desire2Learn site (link can be found at 225K website above).

You will email your research and newsletter assignments to your instructor using annette.nellen@sjsu.edu. If it formats in a legible manner, you can just paste your homework into your email to your instructor (no need to attach as a word doc). (Do not use Desire2Learn to submit papers.)

Topics	OBJECTIVES - The goal of this lesson is to be able to explain the answers to the following questions and understand the significance of the rules in practice and theory:	Assignment that is due on the date indicated (Reading materials are at 225K website)
1	**Course Overview** ▪ Learning objectives for this course ▪ Relevance of the topics to individual taxpayers	
2	**Interest Expense Limitations for Individuals** • What is interest expense? • How do the interest tracing rules of Reg. §163-8T work and why? • What is personal interest? Why is it non-deductible? What about §221? • What is investment interest expense and what limitations apply to it? • Introduction to home mortgage interest rules	Read (see 225K website): - TRA'86 legislative history on interest expense limitations - §163 and §221 - §1.163-8T - §1.163-9T - Notice 89-35 and FSA 200011025 - Revenue rulings on §163(d) Review: Form 4952

	Home Mortgage Interest Limitations • What is home mortgage interest? • What limitations apply to home mortgage interest? • What is the tax treatment of points? • What issues can arise from refinancings? • What planning opportunities arise from the home mortgage interest rules? • What recordkeeping is needed to comply with all of the interest expense rules for individuals? **Tax-exempt interest income and related interest expense**	Read (see 225K website): - §163(h) - §1.163-10T - Form 1098 - Rev Rul. 87-22 - Rev Proc 87-15 - Rev Rul 92-91 - §265 and §1.265-2 (RIA or CCH)
3	**Passive Activity Loss Limitation Rules** **Introduction** • Why do we have §469? • What does §469 entail? • Is §469 a method of accounting? • What is the basic rule of §469? • Who is subject to §469? • What is a passive activity? (§1.469-1(e)) • What is a rental activity? (§1.469-1(e)(3)) • What is a trade or business? • What is material participation and the 7 tests? (§1.469-5) • What form is used to report and track PALs and PACs?	Read (see 225K website): - TRA'86 legislative history - IRS Pub 925 - §469 Skim: Form 8582
	Passive Activity Loss Limitation – More definitions and special rules • What is an "activity"? • Details – passive activity income, passive activity deduction, passive activity credit • Recharacterization rules – when might income not be PAI? (§1.469-2(f)) • What special rules apply to rental real estate with active participation? • What special rules apply to real estate professionals? • What is the self-charged interest rule?	Read (see 225K website): - 1993 legislative history - §469 regulations (-1, -2, -3, -4, -7, -9) - Rev. Proc. 2011-34

	Passive Activity Loss Limitation – special rules • What happens to suspended PALs and PACs upon disposition of a passive activity? • What does "disposition" mean? • How does §469 interact with other IRC sections and rules? • How does §469 apply to passthrough entities? • How does §469 apply to publicly-traded partnerships? • Cautions in dealing with §469 • Reporting PALs and related recordkeeping	Read (see 225K website): - §469 regulations (-10 and review -5 and -5T) - Rev Rul 92-92 - Notice 2008-64 - Form 8582 and instructions
4	**Individual Alternative Minimum Tax (AMT)** • What is AMT? • Why do we have AMT? • Which individuals owe AMT? • How is AMT computed for an individual? • How can AMT be avoided? • What is the minimum tax credit (MTC) and how is it computed and used? • What recordkeeping is needed for AMT? • What issues currently exist for the AMT?	Listen: Deloitte DebriefsU webcast – "Alternative Minimum Tax — The Least Understood Issue in Individual Taxation Today" (see 225K website on AMT) Read: See 225K website
5	**Special topics related to course topics** • Student contributions to class newsletter • Rental of residences • California differences • AMT reform • Major federal tax reform • Legislative outlook	Read: See 225K website
6	**Net Operating Losses (NOLs) of Individuals** • What is an NOL? • How is an NOL computed for individuals? • What are the carryover rules? • What recordkeeping is needed?	
7	**Final Exam** (available between 9 am on Saturday December 3 and 10 pm on Friday December 9, 2011; but you must take it all at one time, so select your start time wisely!)	150 minutes

Research/Application Questions

Be sure to explain all of your answers and provide the citations to the relevant primary authority.

Interest Expense (DUE by 10/3/10) [32 points]

1. In 2010, Bart borrowed $45,000 for use in his Schedule C business and needed no collateral. Explain how each of the following uses of the debt proceeds is treated. Bart wants to maximize his deductions.
    a. $10,000 used to purchase inventory for the business.
    b. $8,000 used to pay interest owed on an earlier Schedule C debt.
    c. $5,000 used to pay college tuition for Bart's son.
    d. $15,000 to put a new roof on Bart's home. He has no office in the home.
    e. The balance not used sits in Bart's checking account.

2. How would your answers change for Bart if the bank required him to put his home up as collateral on the $45,000 loan. Bart has not other home equity debt on his home and his acquisition debt on the home is $120,000.

3. In December 2010, Sarah borrowed $1.6 million to buy a home costing $2 million.
    a. How should she treat the interest expense on her 2011 tax return?
    b. Would the answer change if Sarah co-owned the home with her cousin and both were liable on the mortgage? Explain.

4. Jeremy borrowed $700,000 and used $400,000 of his savings to build a home to use as his principal residence. Construction began on 4/1/09 and the home was completed on 7/1/10.
    a. May Jeremy deduct the interest incurred during the construction period? Explain.
    b. On 7/13/10, Jeremy borrowed $100,000 secured by his new home. What types of debt is this? Explain.

Passive Activities (DUE by 11/7/10) – 30 points

1. This year, Jane started a tutoring business which she operates out of a small office in a strip mall. Jane has one full-time employee in the tutoring business. Jane only works at tutoring about 5 hours per week. Jane also started selling school supplies as a contractor for School Stuff, Inc. She earns 15% commission on everything she sells. Jane sells the supplies by encouraging her pupils to buy from her, going door to door, posting ads on Craig's List and elsewhere. This year, about 20% of her sales were to her tutoring students. Jane devoted 15 hours per week on average to her sales activity. Jane made a profit on the sales, but a loss on the tutoring. Answer the following and explain your answers.

    a. How many activities does Jane have?

    b. Is she a material participant?

    c. If Jane groups the activities, how will the IRS know?

2. Eric has the following activities

Activity	Type	Date acquired	2010 income (loss)	# hours
A	Rental – single family residence	1999	($6,000)	100
B	Limited partnership operating a fast food franchise	2004	($7,000)	-0-
C	Photography business operated as a sole proprietorship, no employees	2008	$9,000	350
D	Car wash business with five employees	2002	$3,000	400
E	Publicly-traded partnership	1994	$4,200	-0-

a. How much income or loss will Eric report on his 2010 Form 1040 if his AGI is $120,000? Explain how each item is treated and why.

b. If Eric's photography business had one employee who worked 700 hours per year, how would your answer to (a) change?

3. Pam is a partner in a law partnership. She rents a building she owns to the partnership and charges fair rental of $8,000 per month, generating net rental income for herself. Is this a "rental activity" under §469 for Pam? Does it produce PAI for her? Explain.

AMT (DUE by 11/21/10) 14 points

1. Information for Mr. and Mrs. Smith for 2010 is listed below. They have two dependent children and claimed dependency exemptions for them. The deduction and income items listed below have already been used to calculate their $190,000 of taxable income. They itemized their deductions (all of their itemized deductions are listed below) and had no capital gains or losses.
   a. Calculate their 2010 AMT (if any) (show the details of your calculation).
   b. Which of the items that affect AMT will create a minimum tax credit for the Smiths?

Taxable income	$190,000
Mortgage interest on debt to acquire principal residence; debt balance is below $1 million.	$25,000
Mortgage interest on home equity debt; balance is under $100,000.	$6,000
Property taxes on residence	$7,000
State income taxes	$6,200
Charitable contributions	$4,000
Miscellaneous itemized deductions claimed on Schedule A	$400
Spread on exercise of ISO	$38,000
Private activity bond interest on bonds purchased in 2004	$3,000

University Policies

Academic integrity

Students are expected to be familiar with the University's Academic Integrity Policy. Your own commitment to learning, as evidenced by your enrollment at San José State University, and the University's Academic Integrity Policy requires you to be honest in all your academic course work. Faculty members are required to report all infractions to the Office of Student Conduct and Ethical Development. The policy on academic integrity and other resources related to student conduct can be found at http://sa.sjsu.edu/student_conduct.

You are to do your own individual work on ALL class assignments. DO NOT share course materials or your quiz results or research assignments with other students. The final exam is open notes. During any quiz or final exam, you MAY NOT phone a friend, poll the audience or text anyone or do anything similar!

Campus Policy in Compliance with the American Disabilities Act

If you need course adaptations or accommodations because of a disability, or if you need to make special arrangements in case the building must be evacuated, please make an appointment with me as soon as possible, or see me during office hours. Presidential Directive 97-03 requires that students with disabilities requesting accommodations must register with the DRC (Disability Resource Center) to establish a record of their disability.

Special accommodations for exams require ample notice to the testing office and must be submitted to the instructor well in advance of the exam date.