Professor Lathrope
Fall 2016
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FEDERAL TAXATION OF PROPERTY DISPOSITIONS
Online Course
Syllabus

COURSE DESCRIPTION:

Federal Taxation of Property Dispositions is a course which examines the concepts and principles governing the federal income taxation of property dispositions, including: amount realized and basis, the treatment of liabilities, characterization of gains and losses, loss limitations, and nonrecognition transactions.

REQUIRED COURSE MATERIALS:

References to "FLLS" are to Freeland, Lathrope, Lind & Stephens, Fundamentals of Federal Income Taxation (18th ed., 2016). Supplementary reading items are referred to by their item number.

Internal Revenue Code & Regulations. Sections of the Internal Revenue Code and regulations should be reviewed as they are assigned in the syllabus and discussed in the Text. The Code and regulations may be accessed online through law school data bases or other online sources.

LEARNING OUTCOMES

The learning outcomes for the course include: (1) Knowledge and understanding of doctrine, (2) Development of skills in statutory construction, (3) Ability to engage in legal analysis and reasoning, and (4) Efficacy in problem-solving.

EXAMINATION AND GRADING:

Your grade will be based on anonymously graded mid-term and final examinations. The mid-term will count one-third of the grade and the final will count two-thirds of the grade. Check on the law school website for the dates of the exams. For the exam, you will be allowed to use the course materials and anything prepared by you (including class notes). A simple calculator may be used. Grading will be on the law school's scale of A, B, C, D and F with pluses and minuses.

OFFICE HOURS:

Office hours will be online Zoom sessions. The Zoom I.D. and the times for the seesions will be emailed to students. Prof. Lathrope can be reached by email to arrange a phone conversation at other times.

HOURS OF WORK PER CLASS

The American Bar Association standards for accrediting law schools contain a formula for calculating the amount of work that constitutes one credit hour. According to ABA Standard 310(b)(1), "a 'credit hour' is an amount of work that reasonably approximates: (1) not less than one hour of classroom or direct faculty instruction and two hours of out-of-class student work per week for fifteen weeks, or the equivalent amount of work over a different amount of time." This is a 2-credit hour class. All told, applying the ABA standard to the number of credits offered for this class, in a full semester course you should plan on spending, on average, a total of 6 hours per week on course-related work. In a seven week course, the average time spent per week would be 12 hours.

Module 1 **Welcome to the Course**

Module 2 **Introduction**
Code §§ 61(a)(3); 1001(a), (b) first sentence, (c); 1011(a); 1012(a); 1016(a)(1)
Regs. §§ 1.61-6(a); 1.1001-1(a)
FLLS 119-120

Module 3 **"Realization": Introduction**
Regs. § 1.1001-1(a) (first sentence), (c); Skim § 1.1001-3
Item 1 (LTR 200411023), Item 2 (Rev. Rul. 81-292)

Module 4 **Realization: Leases**
FLLS 403-406; Item 3 (Frank Lyon Co. v. United States), Item 4 (Rev. Proc. 2001-28)

Module 5 **Realization: Cottage Savings**
Code Skim §§ 475(a); 1256(a)(1), (b)(1)
Item 5 (Cottage Savings Ass'n. v Commissioner)

Module 6 **"Property"**
Code §§ 61(a)(3), 83(a), 1221(a) (introduction), 1231(b)(1) (introduction)
Regs. §§ 1.61-6(a) (second sentence), 1.83-3(e)
FLLS: 793-796 (pay close attention to the precedents cited in *Watkins*)

Module 7 **Basis: Introduction**
Code §§ 1011(a), 7701(a)(42)-(44)
Regs. §1.1001-1(a)

Module 8 **"Cost" as Basis**
Code: §§ 109, 263(a), 1011(a), 1012(a), 1016(a), 1019, 1234(a)
Regs. §§ 1.61-2(d)(2)(i), 1.1012-1(a)
FLLS 123-124

1. Owner purchases some land for $10,000 and later sells it for $16,000.

(a) Determine the amount of Owner's gain on the sale.

(b) What difference in result in (a), above, if Owner purchased the land by paying $1,000 for an option to purchase the land for an additional $9,000 and subsequently exercised the option?

(c) What result to Owner in (b), above, if rather than ever actually acquiring the land Owner sold the option to Investor for $1,500?

(d) What difference in result in (a), above, if Owner purchased the land by making a $2,000 cash payment from Owner's funds and an $8,000 payment by borrowing $8,000 from the bank in a recourse mortgage (on which Owner is personally liable)? Would it make any difference if the mortgage was a nonrecourse liability (on which only the land was security for the obligation)?

(e) What result in (a), above, if Owner purchased the land for $10,000, spent $2,000 in clearing the land prior to its sale, and sold it for $18,000?

(f) What difference in result in (e), above, if Owner had previously rented the land to Lessee for five years for $1,000 per year cash rental and permitted Lessee to expend $2,000 clearing the property? Assume that, although Owner properly reported the cash rental payments as gross income, the $2,000 expenditures were properly excluded under § 109. See § 1019.

(g) What difference in result in (a), above, if when the land had a value of $10,000, Owner, a real estate salesperson, received it from Employer as a bonus for putting together a major real estate development, and Owner's income tax was increased $3,000 by reason of the receipt of the land?

Module 9 Philadelphia Park Amusement v. United States

FLLS: 120-123

Module 10 Capitalization Issues: Introduction

Code §§ 162(a), 212, 262, 263(a), 263A(a) & (b)

Regs. §§1.162-1(a); 1.212-1(a), (k) & (n); 1.263(a)-1(a)-(e); skim § 1.263(a)-1(f); 1.263(a)-3(e)(1), (2)(i), (3)(i), (6) Example 8 & 9

Module 11 Capitalization Issues: Amounts Paid to Acquire or Produce Tangible Property

Regs. §§ 1.263(a)-2

FLLS 340-343

Module 12 Capitalization Issues: Amounts Paid to Acquire or Create Intangibles

Regs. § 1.263(a)-4

FLLS 351-360

Module 13 Basis: Allocation and Identification Issues

Reg. § 1.61-6(a)

FLLS 916-917 (regarding the *Inaja Land Co*. case); Item 6 (Rev. Rul. 68-291)

1. Investor purchased three acres of land, each acre worth $100,000 for $300,000. Investor sold one of the acres in year one for $140,000 and a second in year two for $160,000. The total amount realized by Investor was $300,000 which is not in excess of her total purchase price. Does Investor have any gain or loss on the sales?

2. In 2005, T acquires 750 acres of land for $500,000. At the time of the purchase, the land did not have any water rights but it is part of an irrigation district formed to acquire and distribute water to all of the land in the district. At the time of the purchase, the T's parcel was eligible to receive irrigation water from the district and in 2008 the T obtained the right to water. In 2012, the T sold 50% of the property's water right to an adjacent landowner for $200,000. What is T's gain or loss on the sale?

3. T bought 100 shares of X Co. stock at $50 per share on February 10 of year one and another 100 shares at $60 per share on March 10 of year one. T sold 100 of the shares on April 15 of year two for $65 per share. How much gain or loss does T have? See Reg. §1.1012–1(c)(1)-(3). What difference if T had purchased units in a mutual fund rather than shares of X Co. stock? See Reg. § 1.1012-1(e)(1).

Module 14 Basis: Property Acquired by Gift

Code §§ 102, 1015(a), 7701(a)(43). See §§ 1015(d)(1)(A), (4) and (6).
Regs. § 1.1015-1, 1.1015-5(c)
FLLS 125-132

1. Donor gave Donee property under circumstances that required no payment of gift tax. What gain or loss to Donee on the subsequent sale of the property if:

(a) The property had cost Donor $20,000, had a $30,000 fair market value at the time of the gift, and Donee sold it for:

(1) $35,000?
(2) $15,000?
(3) $25,000?

(b) The property had cost Donor $30,000, had a $20,000 fair market value at the time of the gift, and Donee sold it for:

(1) $35,000?
(2) $15,000?
(3) $24,000?

2. Father had some land that he had purchased for $100,000 but which had increased in value to $200,000. He transferred it to Daughter for $100,000 in cash in a transaction properly identified as in part a gift and in part a sale. Assume no gift tax was paid on the transfer.

(a) What gain to Father and what basis to Daughter under Reg. §§ 1.1001–1(e) and 1.1015–4?

(b) Suppose the transaction were viewed as a sale of one-half of the land for full consideration and an outright gift of the other one half. How would this affect

Father's gain and Daughter's basis? Is it a more realistic view than that of the Regulations? Cf. §§ 170(e)(2) and 1011(b), relating to bargain sales to charities.

Module 15 Basis: Special Issues Involving Property Acquired by Gift

FLLS: 285-290

Module 16 Basis: Property Acquired Between Spouses or Incident to a Divorce

Code §§ 1041, 1015(e)
Regs. § 1.1041-1T(a)-(e)
FLLS 133-134, 222-227

1. Andre purchased some land ten years ago for $40,000 cash. The property appreciated to $70,000 at which time Andre sold it to his wife Steffi for $70,000 cash, its fair market value.

(a) What are the income tax consequences to Andre?
(b) What is Steffi's basis in the property?
(c) What gain to Steffi if she immediately resells the property?
(d) What results in (a)–(c), above, if the property had declined in value to $30,000 and Andre sold it to Steffi for $30,000?
(e) What results (gains, losses, and bases) to Andre and Steffi if Steffi transfers other property with a basis of $50,000 and value of $70,000 (rather than cash) to Andre in return for his property?

2. Brad and Jen's divorce decree becomes final on January 1 of year one. Discuss the tax consequences of the following transactions to both Brad and Jen:

(a) Pursuant to their divorce decree, Brad transfers to Jen in March of year one a parcel of unimproved land he purchased 10 years ago. The land has a basis of $100,000 and a fair market value of $500,000. Jen sells the land in April of year one for $600,000.
(b) Same as (a), above, except that the land is transferred to satisfy a debt that Brad owes Jen. The land has a basis of $500,000 and a fair market value of $400,000 at the time of the transfer. Jen sells the land for $350,000.
(c) What result if pursuant to the divorce decree, Brad transfers the land in (a), above, to Jen in March of year four.
(d) Same as (c), above, except that the transfer is required by a written instrument incident to the divorce decree.
(e) Same as (c), above, except the transfer is made in March of year seven.

Module 17 Basis: Property Acquired From a Decedent

Code §§ 1014(a), (b)(1) and (6), (c), (e), (f); 691(a)(1)-(3)
Regs. §§ 1.1014-3(a), 20.2031-1(b)
FLLS 135-137, 939-942

In the current year, Giver holds two blocks of identical stock, both worth $1,000,000. Giver purchased the first block years ago for $50,000 and the second block more recently for $950,000. Giver plans to make an inter vivos gift of one block and retain the second until death. Which block of stock should Giver transfer inter vivos and why?

Module 18 The Amount Realized: Introduction

Code § 1001(b)
Regs**.** §§ 1.1001-1(b)
FLLS 138-140, 769-774

Module 19 The Amount Realized: Crane
FLLS 141-149

Module 20 Problems on Liabilities
Code § 7701(g)
Regs. 1.1001-2
FLLS 150-158

Mortgagor purchases a parcel of land from Seller for $100,000. Mortgagor borrows $80,000 from Bank and pays that amount and an additional $20,000 of cash to Seller giving Bank a nonrecourse mortgage on the land. The land is the security for the mortgage which bears an adequate interest rate.

(a) What is Mortgagor's cost basis in the land?

(b) Two years later when the land has appreciated in value to $300,000 and Mortgagor has paid only interest on the $80,000 mortgage, Mortgagor takes out a second nonrecourse mortgage of $100,000 with adequate rates of interest from Bank again using the land as security. Does Mortgagor have income when she borrows the $100,000? See Woodsam Associates, Inc. v. Commissioner, 198 F.2d 357 (2d Cir.1952).

(c) What is Mortgagor's basis in the land if the $100,000 of mortgage proceeds are used to improve the land?

(d) What is Mortgagor's basis in the land if the $100,000 of mortgage proceeds are used to purchase stocks and bonds worth $100,000?

(e) What result under the facts of (d), above, if when the principal amount of the two mortgages is still $180,000 and the land is still worth $300,000, Mortgagor sells the property subject to both mortgages to Purchaser for $120,000 of cash? What is Purchaser's cost basis in the land?

(f) What result under the facts of (d), above, if instead Mortgagor gives the land subject to the mortgages and still worth $300,000 to her Son? What is Son's basis in the land?

(g) What results under the facts of (f), above, if Mortgagor gives the land to her Spouse rather than to her Son? What is Spouse's basis in the land? What is Spouse's basis in the land after Spouse pays off the $180,000 of mortgages?

(h) What results to Mortgagor under the facts of (d), above, if the land declines in value from $300,000 to $180,000 and Mortgagor transfers the land by means of a quitclaim deed to Bank? See Parker v. Delaney, 186 F.2d 455 (1st Cir.1950).

(i) What results to Mortgagor under the facts of (h), above, if the land declines in value from $300,000 to $170,000 at the time of the quitclaim deed? See also § 1.1001-2(c) Example (8).

Module 21 Liabilities and Discharge of Indebtedness
Code § 108
Regs. 1.1001-2
FLLS: 171-172

Module 22 Contingent or Illusory Liabilities
Item 7 (Mayerson v Commissioner and Estate of Franklin v. Commissioner)

Module 23 Contingent and Deferred Payment Sales

Code §§ 453(a)-(d)(1), (j)(2)
Regs. §§ 15a.453-1(d)(2)(iii)
FLLS 912-920

Module 24 Carve Outs and Bootstrap Sales

Item 8 (Alstores Corp. v. Commisssioner--note the discussion in *Alstores* of the *McCulley Ashlock* case)

Module 25 The Mechanics of Capital Gains

Code §§ 1(c), (h); 1222, 1411. See §§ 1(a)-(e), (i)(3); 1201(a); 1202(a)-(e).
FLLS 743-755, 1003-1005

Module 26 Problems on Mechanics of Capital Gains

1. T, a single taxpayer, has a salary of $50,000 in the current year. T also has the following transactions all involving the sale of capital assets: (1) a gain of $15,000 on a "collectible" held for 2 years; and (2) a gain of $20,000 on stock held for 15 months.

(a) Determine the amount of T's net capital gain.
(b) At what rate will the components of T's net capital gain be taxed?
(c) Assuming there is a flat 30% tax on ordinary income and disregarding any deductions (including the standard deduction and personal exemption), what is T's tax liability in the current year?

2. S, a single taxpayer, has a salary of $500,000 in the current year. S also has the following transactions involving the sale of capital assets: (1) a gain of $120,000 on stock held for 15 months and (2) a loss of $20,000 on stock held for 3 years. Assume there is a flat 30% tax on ordinary income and disregarding any deductions (including the standard deduction and personal exemption), what is S's tax liability under Section 1 in the current year?

3. Taxpayer, who is the highest federal tax bracket in the current year, has a $5,000 gain from a collectible and a $5,000 gain from stock, both held long-term.

(a) What is Taxpayer's net capital gain and how is it taxed if Taxpayer also has a $5,000 loss from a collectible held long-term?
(b) What results in (a), above, if instead Taxpayer's $5,000 loss is from stock held long-term?
(c) What results in (a), above, if instead Taxpayer's $5,000 loss is from stock held for 9 months rather than from the collectible?
(d) What is Taxpayer's net capital gain and how it is taxed if Taxpayer has a $5,000 gain from a collectible, a $5,000 unrecaptured Section 1250 gain, a $5,000 gain from stock, and a $10,000 loss from stock, all held long-term?

Module 27 The Mechanics of Capital Losses

Code §§ 1211; 1212(a)(1), (b); 1222(10). See §§ 165(c), (f)
FLLS: 756-761

Here are two questions on capital losses incurred in the current year. The figure for taxable income given in column A reflects a single taxpayer's taxable income for each of two years *without* regard to his capital gains and losses. Note that in computing gross income (as adjusted) on the return no gains will be included, since capital losses exceed capital gains and the § 1211(b) excess amount will be a reduction (see note 4, page 648 of FLLS).

	Taxable Income	LTCG	LTCL	STCG	STCL
1.	$10,000	$2,000	$6,000	$2,600	$1,000
2.	10,000	2,000	10,000	2,000	4,000

For each year separately, without regard to computations for other years, determine the amount of the taxpayer's capital loss that is allowed as a deduction from ordinary income under § 1211(b)(1) or (2) and the amount and character of his capital loss carryover, if any, under § 1212(b).

Module 28 The Meaning of "Capital Asset"

Code §§ 1221, 1236

FLLS 761-769, Item 9 (Endicott v. Commissioner)

Module 29 The Sale or Exchange Requirement

Code § 1222. See §§ 165(g)(1), 1235, 1241, 1253, 1271

FLLS 769-777

Module 30 The Holding Period

Code § 1223. See §§ 1014(a), 1015(a), 1041(b)(2), 1222, 1233, 1259.

FLLS 778-783

Taxpayer, a cash method, calendar year taxpayer, engaged in the following transactions in shares of stock. Consider the amount and character of T's gain or loss in each transaction:

(a) T bought 100 shares of stock on January 15 of year one at a cost of $50 per share. T sold them on January 16 of year two at $60 per share.

(b) T bought 100 shares of stock on February 28 of year one at a cost of $50 per share. T sold them on February 29 of year two, a leap year, for $60 per share.

(c) T bought 100 shares at $50 per share on February 10 of year one and another 100 shares at $50 per share on March 10 of year one. T sold 100 of the shares on February 15 of year two for $60 per share. See Reg. §§ 1.1223–1(i) and 1.1012–1(c)(1)(i).

(d) T told T's broker to purchase 100 shares of stock on December 29 of year one at a time when its price was $50 per share. The stock was delivered to T on January 3 of year two when it was selling for $52 per share. T told T's broker to sell the stock on December 30 of year two when it sold for $60 per share, and it was delivered to Buyer on January 4 of year three when it was selling for $63 per share.

(e) Same as (d), above, except that the value of the stock on December 30 of year two was $45 per share and on January 4 of year three was $48 per share.

(f) T's father bought 100 shares of stock on January 10 of year one at $30 per share. On March 10 of year one when they were worth $40 per share he gave them to T who sold them on January 15 of year two for $60 per share (see § 1223(2)).

(g) T's father purchased 1000 shares of stock for $10 per share several years ago. The stock was worth $50 per share on March 1 of year one, the date of Father's death. The stock was distributed to T by the executor on January 5 of year two and T sold it for $60 per share on January 15 of year two.

(h) Same as (g), above, except that T was executor of T's father's estate and as such T sold the stock on January 15 of year two for $60 per share to pay the estate's administration expenses.

Module 31 Judicial Gloss on the Statute: "Income" Property

Code § 1241
FLLS 784-796

1. Agent entered into a contract with a national insurance Company to manage its State office for a ten year period. After two years Company decides to discontinue its State operations and agrees to pay Agent $50,000 to terminate her contract. What result to Agent?

2. Suppose a taxpayer owns dividend-producing stock and sells the rights to the dividends for the next five years for $10,000. What is the character of taxpayer's gain in that case?

3. Landlord L owns two contiguous parcels of land. L leases both parcels to Tenant T for $1,000 per month per parcel or a total of $24,000 per year; the rent is payable at the end of each year. The lease is for a 10 year period. Upon the following events, which occur more than one year after the lease is signed, what are the results:

(a) To L if L sells the right to the rents on both parcels, prior to any rental payments being due or paid, to a third party for $200,000?
(b) To L if T pays L $20,000 to cancel the leases on both parcels?
(c) To T if L pays T $20,000 to cancel the leases on both parcels?
(d) To T, if after subleasing one of the parcels of land to S for $1200 per month for a five year period, S pays T $10,000 for all T's rights in the lease on that parcel and L releases T from the lease and accepts S as the new tenant?
(e) To T if S subleases one parcel of land from T at $1200 per month for the remainder of T's ten year period?

Module 32 Correlation with Prior Transactions & Statutorily Created Capital Gain and Loss Consequences

Code: 165(g), 166(d), 1222, 1234, 1234A, 1235, 1236, 1237, 1241, 1253, 1271
FLLS 797-801, 805-811

Module 33 § 1231 Recharacterization: Introduction

Code § 1231
FLLS 811-819

Module 34 § 1231 Recharacterization: Problems

1. Hotchpot engaged in (or encountered) the following transactions (or events) in the current year. Determine separately for each part (a) through (i) how the matters indicated will be characterized for the current year, assuming in all parts other than (g)–(i) that § 1231(c) is inapplicable.

(a) Hotchpot sells some land used in his business for four years for $20,000. It had cost him $10,000. He also receives $16,000 when the State condemns some other land that he had purchased for $18,000 three years ago which he has leased to a third person.

(b) Same as (a), above, except that both pieces of land were inherited from Hotchpot's Uncle who died three months before the dispositions. At Uncle's death, the business land was worth $16,000 and the leased land was worth $18,000.

(c) Hotchpot sells a building used for several years in his business, which he depreciated under the straight-line method. The sale price is $15,000 and the adjusted basis $5,000. His two year old car, used exclusively in business, is totally destroyed in a fire. The car had a $6,000 adjusted basis but was worth $8,000 prior to the fire. He received $4,000 in insurance proceeds. See Reg. § 1.165-7(b)(1).

(d) In addition to the building and the car in (c), above, assume that Hotchpot had a painting that he had purchased two years ago which was held in connection with his business and which was also destroyed in the fire. The painting had been purchased for $4,000 and he received $8,000 in insurance proceeds.

(e) In addition to the building sale, car loss, and painting gain in (c) and (d), above, assume Hotchpot sells land used for several years in his business for $30,000. The land, which he had hoped contained oil, had been purchased for $50,000.

(f) Would Hotchpot be pleased if the Commissioner successfully alleged that the land in problem (e), above, was held as an investment rather than for use in Hotchpot's business?

(g) What result under the facts of (d), above (building gain, car loss, and painting gain), if four years before the fire Hotchpot had had a $5,000 net § 1231 loss and three years before a $3,000 net § 1231 loss, and he had had no other § 1231 transactions in other years.

(h) Same as (g), above, except that in addition two years before the tax year Hotchpot had a $6,000 net § 1231 loss.

(i) Same as (h), above, except that one year before the tax year Hotchpot had had a $10,000 net § 1231 gain.

2. Car Dealer uses some cars for demonstration purposes. Are the cars depreciable? Disregarding § 1245 if they are held long-term does gain on their sale qualify for § 1231(a) main hotchpot treatment? See Rev.Rul. 75–538, 1975–2 C.B. 34.

Module 35 Methods of Cost Recovery: Introduction

Code §§ 167 (note § 167(b)), 168, 179, 197, 1016(a)(2); Skim §§ 174, 195, 263(c), 280F, 616, & 617.

Regs. §§ 1.167(a)-2, -3; 1.167(b)-0(a), -1(a), -2(a); 1.167(g)-1; 1.179-1(e); 1.165-9(b)(2), 1.212-1(h)

FLLS 428-462; Skim Item 10 (Rev. Proc. 87-56); read Item 11 (Rev. Proc. 87-57) and Item 12 (Rev. Rul. 2001-60)

Module 36 Methods of Cost Recovery: Problems

1. On January 2 of the current year for $300,000 Depreciator purchases new equipment for use in her business. The purchase is made from an unrelated person. The equipment has a 6–year class life and is 5–year property under § 168(c). Depreciator plans to use the equipment for seven years, and expects it to have a salvage value of $30,000 at the end of that time. Depreciator is a single, calendar year taxpayer, and she uses the equipment *only* in her business.

In the following problems compute the depreciation deductions with respect to the equipment in each year of its use assuming that if § 168(k) is applicable in the current year Depreciator elects out of its use, and compute Depreciator's adjusted basis for the property each year.

(a) Depreciator elects under § 168(b)(5) to use the straight-line method for the equipment and all other property in its class placed in service during the year.

(b) Depreciator uses the accelerated ACRS method provided by § 168(a).

(c) Same as (b), above, except that Depreciator disposes of the equipment on December 1 of year five.

(d) What differences from (b), above, if Depreciator also elects to use § 179? Assume there is no post-2015 inflation. What additional facts do you need to know?

(e) The equipment has a 6–year class life and Depreciator elects to use the § 168(g) alternative depreciation system for the equipment and all other property in its class placed in service during the year.

Module 37 Methods of Cost Recovery: Real Property and Special Rules

FLLS 463-466, 491-494

1. During the current year, Depreciator purchases a piece of new improved real property at a cost of $130,000 of which $100,000 is attributable to the building and $30,000 to the land. Depreciator immediately rents the property to others. Compute Depreciator's depreciation in the subsequent year in the following situations:

(a) The building is an apartment building.

(b) The building is an office building.

2. Homeowners purchased their vacation residence for $180,000 ($20,000 of which was allocable to the land). When it was worth $160,000 ($20,000 of which was allocable to the land), they moved out, rented the property, and properly took $10,000 of depreciation on it. What result when they subsequently sell the property for:

(1) $145,000?

(2) $175,000?

(3) $165,000?

Module 38 Depreciation Recapture: § 1245

Code §§ 1016, 1245. See §§ 179(d)(10), 1239, 1252, 1254

Regs. §§ 1.179-1(e), 1.1245-6(a)

FLLS 831-837

1. Recap, a calendar year taxpayer, owns a piece of equipment that Recap uses in business. The equipment was purchased in year one for $100,000, is "5–year property" within the meaning of § 168(c), and Recap has taken the ACRS deductions on it allowed by § 168. Recap did not elect § 179. Assume Recap has no net § 1231 losses in prior years.

(a) What result to Recap if Recap sells the equipment to Buyer in year seven for $30,000?

(b) What difference in result if Recap had elected to use § 179?

(c) What result to Recap in (a), above, if Recap had failed to take any depreciation deductions on the equipment? Would Recap be content to let things be or would Recap want to seek a refund based on depreciation allowable for prior years?

(d) What results in (a), above, if Recap sells the equipment to Spouse?

(e) What result if as a result of a scarcity of equipment Recap is able to sell the equipment to Desperate for $110,000?

(f) What result to Recap in (e), above, if in addition Recap sold some land used for storage in Recap's business for $9,000? Recap had owned the land for three years and it had a $20,000 adjusted basis.

(g) Same as (f), above, but the sale price of the land is $15,000?

2. Do you see a significant relationship between § 1245(a)(2) and the transferred basis rules of § 1015 and § 1041(b)(2)? Does the statute sanction assignment of "fruit" in these circumstances?

Module 39 Depreciation Recapture: Treatment of Real Property

Code: § 1250
FLLS: 838-840

1. To what extent does § 1250 apply to real property placed in service after 1986?

2. On January 1 of the year 2000, Owner purchased some commercial real property at a cost of $880,000, of which $780,000 was properly allocable to the building and $100,000 was properly allocable to the land. Owner is a single taxpayer who has $200,000 of ordinary taxable income from services in 2016. Owner sells the property on December 31, 2016 for $1 million, with $890,000 of the purchase price properly allocated to the building and $110,000 properly allocated to the land. Disregard the mid-month convention and assume for depreciation purposes that the property was held for full years in the years 2000 and 2016. Further, assume Owner had no other § 1231 gains or losses in 2016 and no § 1231 losses in prior years.

(a) What results to Owner on the sale of the property in 2016?

(b) What results to Owner on the sale in (a), above, if Owner also had a $20,000 long-term capital loss on the sale of stock?

Module 40 Like Kind Exchanges: Introduction

Code §§ 1001(c), 1031, 1223(1). See §§ 121(d)(1), 1245(b)(4), 1250(d)(4)
Reg. §§ 1.1001(a)-1, -2; 1.1031(b)-1; 1.1031(c)-1; 1.1031(d)-1; 1.1031(j)-1.
Skim § 1.1031(k)-1.
FLLS 955-956, Item 13 (Rev. Rul. 84-121)

T has 100 acres of unimproved land which T farms. Its cost basis is $10,000 but its value much greater. T trades it to B for a city apartment building worth $70,000, which has a basis to B of $30,000, and B transfers to T, as well, $4,000 in cash and 100 shares of X Corp. stock held for 3 years for which B's basis is $40,000 but which have a fair market value of $26,000. None of the property involved is mortgaged, and B always claimed straight line depreciation on the apartment.

(a) As regards T:
 (1) What is T's realized gain on the exchange?
 (2) What is T's *recognized* gain on the exchange?
 (3) What is T's basis for the stock?
 (4) What is T's basis for the apartment building?

(5) Test whether your conclusions seem sensible by determining what the tax consequences to T would be if, immediately after the exchange, T sold the apartment building for $70,000 and the stock for $26,000 (taking account also of the amount on which he was taxed on the exchange), and comparing this with a straight sale of T's farm land (instead of the exchange) for $100,000 cash.

(b) As regards B:

(1) What is B's realized gain and loss on the exchange?

(2) What is B's *recognized* gain or loss on the exchange?

(3) What is B's basis for the farm land acquired?

(4) Could § 1250 affect B on these facts if, instead of straight line, B had claimed accelerated depreciation on the apartment?

(5) Test your conclusions about B by seeing whether a sale of the farm by B for $100,000 immediately after the exchange (and taking account of the tax treatment of the disposition of the stock on the exchange) will yield the same overall results as if initially, instead of making the exchange, B had sold the apartment building for $70,000 and the stock for $26,000.

Note: B's problems are a bit more intricate than T's. It is apparent that B has realized $100,000, the *value* of the farm land. But this amount must be allocated $4,000 to the cash paid, $26,000 to the stock (its value) and $70,000 to the apartment building (its value). See Reg. § 1.1031(d)–1(e), Example. Is it clear that the $4,000 cash paid by B will affect B's adjusted basis, as otherwise determined, for the farm land?

Module 41 § 1031 Continued

Regs. § 1.1031(b)-2
FLLS 967-972

Buyer wants to acquire Seller's investment land. Seller has a substantial gain on the land, hates to pay tax on such gains, and would like to convert the investment to commercial real estate in a tax-free exchange. Discuss the results to Seller in the following alternative situations:

(a) Buyer pays cash for the land and Seller reinvests the proceeds in commercial property.

(b) Seller agrees to sell the land to Buyer who puts cash in an amount equal to the value of the land in an escrow account. The escrow provides for Seller to select commercial property equal in value to the land. Buyer will then acquire the commercial property with the escrowed cash and transfer the property to Seller. If Seller fails to find adequate property, the deal collapses. One year after the escrow account is opened, Seller selects commercial property that Buyer acquires with the escrowed cash and transfers it to Seller in exchange for the land.

(c) Seller, a calendar year taxpayer, transfers the land to Buyer on January 1 of the current year. Buyer puts cash in an amount equal to the value of the land in an escrow account. Seller is to select the like kind property Seller wants and Buyer is to acquire it with the escrowed cash. If at any time Buyer fails to meet Buyer's obligations, Seller may demand the cash. On February 15, Seller identifies 3 properties, any one of which Seller is willing to accept, and on June 15, Buyer acquires one of the properties (having a value equal to the land) and transfers it to Seller.

(d) Same as (c), above, except that after Seller's transfer of the land to Buyer and Buyer's transfer of the cash to the escrow account, but prior to replacement property being acquired, Seller may at any time opt to take the cash, rather than replacement property.

Module 42 Liabilities and other § 1031 Issues

Reg. § 1.1031(d)-2

FLLS 972-974; Item 14 (Rev. Rul. 72-456)

A owns some investment real estate with an adjusted basis of $200,000, worth $500,000 and subject to a nonrecourse mortgage of $100,000.

(a) Discuss the results to A and B if A transfers A's property to B in exchange for B's investment real estate worth $400,000 with an adjusted basis of $100,000.

(b) Discuss the results to A and B if, instead, A transfers A's property to B in exchange for B's investment real estate worth $470,000 with an adjusted basis of $100,000 and subject to a $70,000 nonrecourse mortgage.

(c) Discuss the results to A and B under the facts of (a), above, if A's investment real estate subject to the liability is worth only $450,000 and A transfers $50,000 of cash in addition to A's investment real estate to B in exchange for B's investment real estate.

Module 43 Involuntary Conversions and other Nonrecognition Provisions: Introduction

Code §§ 1033, 1223(1). See §§ 1245(b)(4), 1250(d)(4)

Regs. §§ 1.1033(a)-1, -2; 1.1033(b)-1; 1.1033-1(g)-1

FLLS 976-990

Module 44 Involuntary Conversions and other Nonrecognition Provisions: Problems

Code § 1038

Item 15 (§ 1038 Example)

1. T was in the laundry and dry cleaning business. In the current year a fire completely destroyed the automatic dry cleaning equipment in T's plant. Several years earlier the equipment in T's plant had cost T $40,000 and, since its acquisition, T had properly claimed depreciation on the equipment in the amount of $16,000. After the fire and within the current year, T received $28,000 as insurance covering the loss.

(a) If the dry cleaning end of the business has been unprofitable and T invests the $28,000 in securities, rather than replacing the equipment, what will be the tax consequences?

(b) If the capacity of the old equipment was in excess of T's needs and T replaces the old with smaller new equipment at a cost of $26,000

(1) What will be the immediate tax consequences to T?

(2) What will be T's basis for the purpose of claiming depreciation on the new equipment?

(3) What would be the tax consequences to T if T made a quick change of plans and sold the newly acquired equipment for $26,000 before any depreciation became allowable with respect to it?

2. Taxpayer, who is single, has lived in her principal residence for several years. Taxpayer purchased the home for $100,000 and it was worth $500,000 when it was destroyed in a fire. Taxpayer recovered $450,000 of insurance proceeds. Taxpayer wants to minimize the tax consequences with respect to the residence. What do you suggest that she do? See I.R.C. § 121(d)(5) & Reg. § 1.121–4(d).

3. Would the court have reached the same result in *Harry G. Masser* if a single piece of business property had been damaged and, even though the property could still have been used in the business, the owner of the property "in the exercise of good business judgment" decided, nevertheless, to sell it and use the sale and insurance proceeds to purchase a piece of replacement property? See C.G. Willis, Inc. v. Commissioner, 41 T.C. 468 (1964), affirmed per curiam 342 F.2d 996 (3d Cir.1965).

4. The *Clifton Investment* case reflects a common problem regarding the scope of the term "similar or related in service or use." But suppose in *Clifton Investment* the taxpayer had bought a hotel rather than stock in a hotel corporation. Would the result in the case be different?

5. Rev.Rul. 70–399, 1970–2 C.B. 164, deals with the repurchase of a new hotel with the insurance proceeds received when an old hotel was destroyed by fire. Despite the intrinsic identity of the properties, the case is placed outside the protective covering of § 1033. The owner had leased the old hotel to others to operate but undertook to operate the new hotel himself. Thus the new property was not similar or related in service or use. Why would § 1033(g) be of no help here?

6. The two questions immediately preceding are concerned with some of the differences in the definition of "like kind" under §§ 1031 and 1033(g) and "similar or related in service or use" under § 1033(a). In enacting § 1033(g) the Senate Finance Committee Report stated:

> Both in the case of property involuntarily converted and in the case of the exchange of property held for productive use in trade or business or for investment, gain is not recognized because of the continuity of the investment. Your committee sees no reason why substantially similar rules should not be followed in determining what constitutes a continuity of investment in these two types of situations where there is a condemnation of real property. Moreover, it appears particularly unfortunate that present law requires a closer identity of the destroyed and converted property where the exchange is beyond the control of the taxpayer than that which is applied in the case of the voluntary exchange of business property.
>
> As a result your committee has added a new subsection to the involuntary conversion (sec. 1033) provision of present law. In this new subsection it has added the "like kind" test of the voluntary exchange of business property rule of present law as an alternative in the case of involuntary conversions for the rule requiring the substitution of property "similar or related in service or use." The "like kind" rule in this case applies, however, only in the case of real property, does not include inventory or property held primarily for sale, and is limited to seizures, requisitions, condemnations, or the threat of imminence thereof. Nor does it apply in the case of the purchase of stock in acquiring control of a corporation. * * * Sen.Rep. No. 1893, 85th Cong., 2d Sess. (1958), 1958–3 C.B. 922, 993–4.

Is the restriction of § 1033(g) to condemnations of real property too narrow? Should the two tests of §§ 1031 and 1033 be made alternatives under both sections?

Module 45 § 121: Gain from the Sale of a Principal Residence

Code: §§ 121
Regs. §§ 1.121–1 through -4
FLLS 238-242

1. Determine the amount of gain that Taxpayers (a married couple filing a joint return) must include in gross income in the following situations:

(a) Taxpayers sold their principal residence for $600,000. They had purchased the residence several years ago for $200,000 and lived in it over those years.

(b) Taxpayers in (a), above, purchased another principal residence for $600,000 and sold it 2½ years later for $1 million.

(c) What result in (b), above, if the second sale occurred 1½ years later?

(d) What result in (b), above, if Taxpayers had sold their first residence and were granted nonrecognition under former Section 1034 (the rollover provision) and, as a result, their basis in the second residence was $200,000?

(e) What result in (a), above, if the residence was Taxpayers' summer home which they used 3 months of the year?

(f) What result if Taxpayer who met the ownership and use requirements is a single taxpayer who sold a principal residence for $400,000 and it had an adjusted basis of $190,000 after Taxpayer validly took $10,000 of post–1997 depreciation deductions on the residence which served as an office in Taxpayer's home?

2. Single Taxpayer purchased a principal residence for $500,000 and after using it for one year, Single sold the residence for $600,000 because Single's employer transferred Single to a new job location.

(a) How much gain must Single include in gross income?

(b) What result in (a), above, if Single sold the residence for $700,000?

Module 46 § 121: Gain from the Sale of a Principal Residence Continued

3. Single Taxpayer buys a mountain cabin on January 1, 2011 for $200,000 which Single used as a vacation home through December 31, 2013. In 2013, Single sells her principal residence at a gain which is excluded under § 121. On January 1, 2014, Single moves into the mountain cabin and uses it as her principal residence.

(a) If Single sells the mountain cabin for $350,000 on January 1, 2016, how much of the gain is included in her gross income?

(b) What result in (a), above, if Single sells the mountain cabin for $900,000?

(c) What result in (a), above, if Single purchased the mountain cabin and began using it as a vacation home on January 1, 2006?

(d) Do the nonqualified use rules apply to Single if Single purchases and uses a principal residence for two years, then rents it out for two years prior to selling it?

4. Taxpayer has owned and lived in Taxpayer's principal residence for 10 years, the last year with Taxpayer's Spouse after they married. Spouses decide to sell the residence which has a $100,000 basis for $500,000.

(a) If the Spouses file a joint return do they have any gross income?

(b) What result if the Spouses had lived together for two years in Taxpayer's residence prior to their marriage and sold the residence after one year of marriage for $500,000?

(c) What result in (a), above, if after one year of marriage Taxpayer pursuant to their divorce decree deeded one-half of the residence to Spouse and Spouse lived in the residence while Taxpayer moved out and, one year later, they sold the residence for $500,000?

(d) What result in (a), above, if after one year of marriage Taxpayer pursuant to their divorce decree deeded one-half of the residence to Spouse and Taxpayer continued to occupy the residence while Spouse moved out, and, one year later, they sold the residence for $500,000?

5. Estate Planner sold a remainder interest in Planner's principal residence for $300,000 (its fair market value) to Planner's Son. Planner's basis in the remainder interest was $125,000. Does Planner have any gross income?

Module 47 Loss Limitations: Introduction

Code Skim §§ 465, 469, 165(a)-(h); 166; 172(a); 183(a); 267(a)(1), (b), (c), (d) & (g); 280A(a) & (c); 1091; 1211; 1212

Regs. §§ 1.165-1, -5; 1.166-1

Module 48 Loss Limitations: § 465 At-Risk Limitation

Code § 465; 542(a)(2); 544;

Regs. § 1.465-8, -20, -27

FLLS 557-560

1. Discuss the extent to which § 465 limits Taxpayer's loss deductions, generates recapture income out of a previously allowed loss deductions, or allows the use of a loss carryover in the following situations:

(a) Taxpayer purchased a farm for $50,000 cash and his personal note for $400,000 secured by a mortgage. In the first two years of operation he put in an additional $50,000 each year, by way of cash and personal loans, for feed, fertilizer and other supplies; but things did not go well. In the first year of operations his loss was $80,000 and he had another $80,000 loss in the second year of operations. No principal was paid on the liability in either year.

(b) The facts are the same as in (a), above, except that the farm was acquired for $50,000 cash and $400,000 of nonrecourse financing.

(c) The facts are the same as in (a), above, except that in the third year of operations when the farm broke even, Taxpayer converted his personal liability of $400,000 to a nonrecourse loan.

(d) The facts are the same as in (b), above, except that Taxpayer pays off $10,000 of the nonrecourse loan in year two.

(e) The facts are the same as in (b), above, except that the farm breaks even in year three and Taxpayer pays off $10,000 of the nonrecourse loan in year three.

2. Discuss the extent to which § 465 potentially applies to limit the deductions of Vestor who invests in an apartment house in the following situations:

(a) Vestor obtains a $200,000 nonrecourse loan from an unrelated commercial bank to purchase the apartment from Seller.

(b) The facts are the same as in (a), above, except that Vestor obtains the nonrecourse loan from Seller.

Module 49 Loss Limitations: Introduction to § 469 Passive Activity Limitations

Code § 469

Regs. §§ 1.469-1T(a) through (e)(3), (e)(6), (f), (g)(1) through (4); 1.469-2T(a) through (c)(4), (c)(7), (d)(1) through (d)(6), (d)(8), (e)(1), (f)(1) through (f)(3), (f)(7); 1.469-4; 1.469-5T; 1.469-9

Prop. Regs. §§ 1.469-1 though -7, -9, -11 through -13, -22 through -25, -38, -41, -66

FLLS 576-589

1. Lawyer earns $200,000 of taxable income from her practice in the current year. Discuss the extent to which the following transactions affect her taxable income in the current year.

(a) Lawyer also has $10,000 of dividends and interest in the year. She invests as a limited partner in a partnership that films and distributes movies. Her share of the partnership's movie losses for the year is $50,000.

(b) Same as (a), above, except that Lawyer also has a $30,000 gain from her limited partnership investment in a windmill power tax shelter.

(c) Same as (a), above, except that in the succeeding year the movie limited partnership makes a gain of $90,000 as a result of a successful movie, "Alligator Allee."

(d) Same as (a), above, except that Lawyer sells her movie limited partnership interest at the beginning of the succeeding year at a gain.

(e) Same monetary figures as (a), above, except that Lawyer's limited partnership interest is in rental real estate rather than in a movie.

(f) Same as (e), above, except that Lawyer owns a 20 percent general (not limited) partnership interest in rental real estate in which she actively participates in the management decisions.

(g) Same as (f), above, except that Lawyer's adjusted gross income for the year from her law practice is $120,000 (rather than $200,000).

Module 50 Loss Limitations: § 469 Continued

1. (a) In the current year Grocer purchases a grocery store and spends 35 hours per week operating it to the exclusion of all other business and investment activities. Grocer's loss from the grocery store business is $50,000. How much of his loss is deductible?

(b) Same as (a), above, except Grocer is only irregularly involved in the operation of the grocery store. Intermittently, Grocer makes significant management decisions.

(c) Same as (a), above, except that Grocer who is retired purchases the grocery store and hires a manager who has carte blanche power to make all business decisions.

(d) Grocer, upset with the $50,000 loss in (c), above, fires manager at the end of the year and in the succeeding year, Grocer manages the store on a full-time basis and in that year makes a $60,000 profit. What tax consequences to Grocer for the succeeding year?

2. (a) In year one, Eileen purchases a house and uses it as her primary residence. In year two, Eileen changes her primary residence and decides to rent out her former residence. Eileen hires a rental agent to handle day-to-day problems but she approves new tenants, sets rental terms and approves capital or repair expenditures. Eileen's loss from the rental property is $8,000 and her other adjusted gross income is $40,000. How much of the loss is deductible?

(b) Same as (a), above, except that in year two, Eileen also purchases an undivided interest in a shopping mall. She purchased her interest from a promoter, based on a prospectus describing the investment opportunity and stressing the tax benefits. A professional management company makes all significant management decisions. Eileen's share of the shopping mall loss is $3,000. What amount of her total $11,000 of losses are deductible?

3. Julia owns and runs a catering business which is profitable in Town X. She opens a new catering business in Town Y which is essentially run by her staff in Town Y, although Julia makes management decisions for the business. Julia also has a limited partnership interest in a real estate limited partnership that currently generates losses and expects to do so for the next several years.

Julia asks you to advise her how to treat her Town Y catering business under the passive activity rules.

Module 51 Loss Limitations: § 469 Continued Again

1. In the current year, Dentist purchased two limited partnership interests. For the current year, Dentist had a $20,000 loss and a $7,000 credit from one of the passive activities. In the same year, she had $35,000 of income from the other passive activity. Excluding the passive income and loss amounts, Dentist had $110,000 of adjusted gross income in the current year. Assume all of Dentist's taxable income from the passive activities falls in the 30 percent tax bracket.

(a) What is the amount of Dentist's passive activity credit for the current year?

(b) What result in (a), above, if, in addition, Dentist actively participates in a rental real estate activity in which she has a 20 percent interest and her share of the real estate activity loss is $20,000?

2. Doctor has a limited partnership interest. His passive activity carryover losses from the partnership are $60,000. Doctor's limited partnership interest has an adjusted basis of $50,000 and a fair market value of $100,000.

(a) What are the tax consequences if Doctor sells his interest to an unrelated third party for $100,000?

(b) What are the tax consequences in (a), above, if Doctor's adjusted basis for his partnership interest is $120,000?

(c) What are the tax consequences in (a), above, if Doctor gives his partnership interest to his son?

(d) What are the tax consequences in (a), above, if Doctor sells his partnership interest to his son for $100,000?

(e) What are the tax consequences in (a), above, if Doctor dies prior to any sale?

3. Passive, an attorney, invests $200,000 of cash and borrows $800,000 from a bank on a nonrecourse basis to invest in a solar power energy business. Passive hires Sunny to run the business, although Passive has the final word on major decisions. In the first year of operations, the business loses $300,000. Passive's only other non-portfolio investment is a limited partnership interest in a real estate investment which earns $50,000 during the year.

(a) Discuss the tax consequences to Passive with respect to the $300,000 loss. See Reg. § 1.469–2T(d)(6).

(b) What results in (a), above, if the loan is a recourse loan?

(c) What results in (a), above, if the real estate limited partnership interest earns $300,000 during the year?

Module 52 Sale of a Business

Code §§ 197, 1060, 6721

Regs. §§ 1.197-2(a)-(f), (g)(1) & (2), (k) Examples1-10; 1.1031(j)-1(a); 1.1060-1. Skim § 1.469-4.

FLLS 819-822, 460-462, Item 16 (Peco Foods Inc. v. Commissioner)

Vic purchased a restaurant from Owner and made the following payments as part of that purchase or in starting the restaurant. Determine the deductibility of Vic's payments:

(a) A payment to Owner for goodwill.

(b) A payment to Owner for a covenant not to compete lasting for a five-year period.

(c) A payment to the media to advertise the restaurant.

(d) A payment to the state to acquire a liquor license that has a five-year life. See Reg. § 1.197–2 (c)(13).

(e) A payment to Owner to buy Owner's restaurant franchise