2023 NATIONAL INCOME TAX WORKBOOK

CHAPTER 6: INDIVIDUAL TAX ISSUES PART 1

Land Grant University Tax Education Foundation

INDIVIDUAL TAX ISSUES - PART 1

P. 193

LEARNING OBJECTIVES

- Understand when a taxpayer can claim a loss for a personal casualty
- Calculate the amount of a casualty loss
- Know how to apply the casualty loss deduction limits
- Know how to report a casualty loss
- Understand the taxation of disaster-related provisions
- Know the types of relief that are available to disaster victims

LEARNING OBJECTIVES (Continued)

- Comply with the digital asset reporting requirements
- Explain new reporting requirements for certain digital asset transactions
- Know when a taxpayer can claim a loss for worthless digital assets
- Understand when a taxpayer can claim the home mortgage interest deduction
- Calculate the limits on the home mortgage interest deduction

ISSUE 1: CASUALTY LOSSES

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Casualty Loss Definition

- A ***sudden, unexpected,*** *and* ***unusual*** event that causes damage or destruction of property

- SUDDEN
  - Event is swift, not gradual or progressive
- UNEXPECTED
  - Event is ordinarily unanticipated and unintended
- UNUSUAL
  - Event is atypical, and not a day-to-day occurrence

ISSUE 1: CASUALTY LOSSES

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Casualty Loss Definition

- Progressive deterioration is **NOT** a deductible casualty loss

WHY?

- Because the damage results from a **steadily operating cause** or **normal process** rather than a sudden event

ISSUE 1: CASUALTY LOSSES

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Examples:

- Hurricanes
- Tornadoes
- Earthquakes
- Fires
- Floods
- Car accidents
- Sonic booms
- Terrorist attacks
- Vandalism
- Volcanic eruptions
- Government-ordered demolition of a home rendered unsafe by a disaster

ISSUE 1: CASUALTY LOSSES

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Personal Use Property Loss

- Generally, a taxpayer **cannot** deduct personal expenses (I.R.C. §262)

EXCEPTION

- Losses of personal use property **may** be deductible if:
  - Losses are the result of fire, storm, shipwreck, or another casualty; or theft

For 2018-2025

- Deduction for personal casualty and theft losses is **LIMITED** to:
  - Losses attributable to federally declared disasters

ISSUE 1: CASUALTY LOSSES

NOT IN BOOK

	14	Add lines 11 through 13	14	
Casualty and Theft Losses	15	Casualty and theft loss(es) from a federally declared disaster (other than net qualified disaster losses). Attach Form 4684 and enter the amount from line 18 of that form. See instructions	15	
Other Itemized Deductions	16	Other—from list in instructions. List type and amount:	16	
Total Itemized Deductions	17	Add the amounts in the far right column for lines 4 through 16. Also, enter this amount on Form 1040 or 1040-SR, line 12	17	
	18	If you elect to itemize deductions even though they are less than your standard deduction, check this box . . . . ☐		

For Paperwork Reduction Act Notice, see the Instructions for Form 1040. Cat. No. 17145C **Schedule A (Form 1040) 2022**

ISSUE 1: CASUALTY LOSSES

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Cross-Reference

- ***Business Casualty Loss***
  - When disaster damages property held for business or income-producing purposes
    - $ 100-per-event rule & 10%-of-AGI limitation do **NOT** apply!
    - Loss does **NOT** have to be attributable to a federally declared disaster

ISSUE 1: CASUALTY LOSSES

PP. 195-196

Calculating a Loss

- Lesser of Property's
  - Adjusted tax basis, or
  - Decrease in its fair market value (FMV)
- Reduced by
  - Amount of insurance proceeds received
  - Casualty gains (if any)
  - Loss deduction limits

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Difference between the property's FMV ***immediately before & immediately after*** the casualty
- ◦ Treas. Reg. §1.165-7(a)(2)
  - ◦ Cost of repairs may, in certain cases, be used to measure the decline in FMV
  - ◦ Repairs are to actually be made

ISSUE 1: CASUALTY LOSSES

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- Rev. Proc. 2018-8, 2018-2 I.R.B. 286
  - Provides safe harbor methods
    - Not mandatory
    - However, IRS will not challenge determination if taxpayer qualifies for and uses one of the safe harbor methods

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Personal Use Residential Real Property
  - Real property, including improvements
    - *Such as buildings and ornamental trees and shrubbery*
  - Owned by the individual who suffered a casualty or theft loss
  - Containing at least one personal residence

ISSUE 1: CASUALTY LOSSES

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- **Excludes**
  - Personal residence if any part of the personal residence is used as:
    - Rental property, or
    - Contains a home office used in a trade or business or a transaction entered for profit
    - Does not include a condo, cooperative apartment, mobile home or trailer

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Personal Use Residential Real Property
  - Estimated Repair Cost Safe Harbor
  - De Minimis Safe Harbor Method
  - Insurance Safe Harbor Method
  - Safe Harbor Methods for Federally Declared Disaster Areas

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Personal Use Residential Real Property
  - **Estimated Repair Cost Safe Harbor**
    - Taxpayer may use lesser of two repair estimates
    - Prepared by two separate and independent contractors
      - Licensed or registered in accordance with state or local regulations

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Personal Use Residential Real Property
  - Estimates must show the itemized costs to restore the personal use residential real property to condition existing immediately prior to the casualty
  - Safe harbor available for casualty losses of $20,000 or less
    - Prior to application of the limitations under I.R.C. § 165(h) - (the $ 100 reduction and 10%-of-AGI floor)

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Personal Use Residential Real Property
  - **De Minimis Safe Harbor Method**
    - Taxpayer determines decrease in FMV of personal use residential real property
    - By estimating cost of repairs required to restore property
      - To condition existing immediately prior to the casualty
    - Safe harbor available for casualty losses of $5,000 or less
      - Prior to application of the limitations under I.R.C. § 165(h)

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Personal Use Residential Real Property
  - **Insurance Safe Harbor Method**
    - Taxpayer determines decrease in FMV of personal use residential real property
    - Using estimated loss determined in reports prepared by
      - Taxpayer's homeowners or flood insurance company

ISSUE 1: CASUALTY LOSSES

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Determining the Decrease in Value

- Personal Use Residential Real Property
  - **Safe Harbor Methods for Federally Declared Disasters**
    - Taxpayer determines decrease in FMV of personal use residential real property
    - Using contractor safe harbor method or
    - Disaster loan appraisal safe harbor

ISSUE 1: CASUALTY LOSSES

Determining the Decrease in Value

- Personal Belongings
  - Item of tangible personal property owned by the individual who suffered a casualty or theft loss
    - Not used in a trade or business or in a transaction entered for profit

ISSUE 1: CASUALTY LOSSES

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- **Determining the Decrease in Value**
- Does **not** include:
  - Boat, aircraft, mobile home, trailer, vehicle, or an antique or other asset that maintains or increases its value over time
  - Determine predisaster value by consulting established pricing sources

ISSUE 1: CASUALTY LOSSES

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- **Two Safe Harbors**
  - De Minimis Safe Harbor
    - Available for casualty or theft losses of $5,000 or less
  - Safe Harbor Methods for Federally Declared Disasters
    - Replacement Cost safe harbor
      - Start with current cost to replace
      - Discounted by 10% for each year owned
      - Owned >8 years use 10% of current cost

ISSUE 1: CASUALTY LOSSES

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Proof of Loss

- Must demonstrate all the following:
  - Type of casualty and when it occurred
  - Loss was direct result of casualty
  - Taxpayer owned the property
    - If leased, taxpayer was contractually liable to owner for the damage
  - Whether there is a reasonable expectation of recovery from a claim for reimbursement

ISSUE 1: CASUALTY LOSSES

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Loss Deduction Limits

- Taxpayer must reduce any loss on personal use property by the following:
  - $100 for each separate casualty
  - 10% of the taxpayer's AGI (after the $100 reduction) from the sum of all personal casualty losses incurred during the year
- Report on Schedule A (Form 1040)
  - No tax benefit from the casualty loss if total itemized deductions are less than allowable standard deduction

Q

CHAPTER 6 POLLING QUESTION #1

A casualty loss is a loss because of a sudden, unexpected, and unusual event that causes damage or destruction of property.

True False

ISSUE 1: CASUALTY LOSSES

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Loss Deduction Limits

Practitioner Note

- Qualified Disaster Losses
  - Specified 2020-2021disasters

ISSUE 1: CASUALTY LOSSES P. 198

Losses Offset Gains

- Taxpayer with personal casualty gains can deduct personal casualty losses **not attributable** to a federally declared disaster
  - To extent loss does not exceed the gains.
- Any remaining casualty gains then reduce casualty losses attributable to federally declared disasters, if applicable.

ISSUE 1: CASUALTY LOSSES

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Example 6.1

- Personal Casualty Loss Not Deductible

Example 6.2

- Personal Casualty Loss Offsets Casualty Gain

Example 6.3

- Federally Declared Disaster Loss

ISSUE 1: CASUALTY LOSSES P. 198

Example 6.3

- Federally Declared Disaster Loss

  $20,000 personal casualty loss

  \- 100 per-casualty loss

  \- 6,100 net casualty gain from Example 2

  \- 8,500 10% x $85,000 AGI

  $ 5,300 deductible casualty loss

ISSUE 1: CASUALTY LOSSES

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Calculating a Casualty Gain

- Insurance proceeds > adjusted tax basis in the property at the time of the casualty
- If gain realized, gain is **deferred** under **involuntary conversion** rules
  - When taxpayer reinvests the insurance proceeds in property similar or related in use to the destroyed property

ISSUE 1: CASUALTY LOSSES P. 199

Calculating a Casualty Gain (Continued)

- Replacement period is 2 years after the year the gain is realized generally
- Replacement period is extended to 4 years for loss of taxpayer’s main home and contents
  - Located in a federally declared disaster area
- Nonrecognition of gain is mandatory if property is involuntarily or compulsorily converted

ISSUE 1: CASUALTY LOSSES

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Example 6.4

Deferral of Casualty Gain

$35,000	Insurance Proceeds
(15,000)	Basis in Garage
$20,000	Gain Realized
($20,000)	Gain Deferred
$45,000	Cost of Replacement Property
(20,000)	Gain Deferred
$25,000	Basis of Replacement Property

Figure 6.1 Statement re

Deferral of Casualty Gain

ISSUE 1: CASUALTY LOSSES

P. 200

Reporting Casualty Losses and Gains

- Section A of Form 4684
  - *Casualties and Thefts*
- Net loss is an ordinary deduction under I.R.C. § 165
  - Deducted on Schedule A (Form 1040)
- Net gain is a capital gain
  - Reported on Schedule D (Form 1040)

ISSUE 1: CASUALTY LOSSES

PP. 200 - 202

Reporting Casualty Losses and Gains

Example 6.5

- Casualty Loss of Personal Use Property

Figure 6.2

- Damaged Real & Personal Property

Figure 6.3

- Form 4684, Casualties and Thefts, Section A

ISSUE 1: CASUALTY LOSSES

P. 203

Multiple Casualties during Year

- Calculate losses separately for **each** event
- Loss for each event is reduced by any reimbursement and by $100
- Combined losses reduced by 10% of AGI

ISSUE 1: CASUALTY LOSSES P. 203

Mixed-Use Property (Personal & Business or Income-Producing Purposes)

- Calculate casualty or theft loss deduction **separately** for each portion
- Allocate the adjusted basis and FMV before and after the loss
- Allocate insurance or other reimbursement
- Apply $100 and 10%-of-AGI limitations **only** to loss on **personal use** portion

Practitioner Note

- Adjustments to Basis

ISSUE 1: CASUALTY LOSSES

P. 203

Timing and Deductibility of Losses

- Generally, deductible only in tax year in which casualty occurred
- However, victims of federally declared disasters can deduct their losses in
  - Tax year in which the disaster occurred OR
  - Preceding year

Practitioner Note

- Disaster Loss

ISSUE 1: CASUALTY LOSSES

P. 203 - 204

- **Advantages:**
  - Receive economic benefit of loss deduction sooner (immediate refund)
  - 10%-of-AGI threshold for personal losses will produce a larger refund if prior year's return has lower AGI
  - Election made on Form 4684, Section D
- Rule applies to both personal and business losses

ISSUE 1: CASUALTY LOSSES

P. 204

Actual Reimbursement Less than Expected

- Received in a later year
  - Include the difference as a loss on the return
    - For year in which the taxpayer expects no additional reimbursement

Actual Reimbursement More than Expected

- Received in a later year and claimed a loss deduction in a prior year
  - Include extra reimbursement in income in the year the taxpayer receives the reimbursement

ISSUE 1: CASUALTY LOSSES

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Temporary Living Expenses

- A taxpayer that cannot occupy the principal residence following a casualty
  - Can exclude from gross income insurance reimbursements for the additional living expenses
    - Subtract normal living expenses from actual living expenses incurred
- Living expenses include:
  - Rent, meals, utilities, transportation, and miscellaneous services such as laundry

ISSUE 1: CASUALTY LOSSES

P. 204

- **Example 6.6**
  - Reimbursed Temporary Living Expenses
- **Practitioner Note**
  - Principal Residence in a Disaster Area

ISSUE 2: DISASTER RELIEF

P. 205

- President may declare an area to be eligible for federal assistance
  - Under Robert T. Stafford Relief & Emergency Assistance Act
- Disaster relief payments under this Act
  - May be taxable or may be excluded from income

ISSUE 2: DISASTER RELIEF

P. 205

Disaster Relief Payments

- Typically limited to payments to individuals
  - Include:
    - Grants
    - Loan cancellation
    - Qualified disaster relief payments
    - Qualified disaster mitigation payments

ISSUE 2: DISASTER RELIEF

P. 205

Disaster Relief Payments

- **Grants**
  - Excluded from gross income if:
    - ✓ Made to meet necessary expenses OR
    - ✓ Serious needs for medical, dental, housing, personal property, transportation, or funeral expenses
  - Cannot deduct a casualty loss or medical expense to extent loss or expense is reimbursed by the grant

ISSUE 2: DISASTER RELIEF

P. 205

Disaster Relief Payments

- **Federal Loan Canceled**
  - Debt forgiveness is reimbursement for the loss AND
  - Reduces casualty loss deduction

ISSUE 2: DISASTER RELIEF

P. 205

Disaster Relief Payments

- **Qualified Disaster Relief Payments**
  - Excluded from income received from **ANY** source in tax year
    - Ending on or after **September 11, 2001**

ISSUE 2: DISASTER RELIEF

P. 205

- Qualified payments include payments received
  - As a result of federal declared disaster
  - For unreimbursed expenses that are **reasonable and necessary** such as:
    - ➢ Personal, family, living, or funeral expenses
    - ➢ Repair or rehabilitation of personal residence
    - ➢ Repair or replacement of contents of personal residence

ISSUE 2: DISASTER RELIEF

P. 206

Disaster Relief Payments

- **Qualified Disaster Mitigation Payments**
  - Excluded from income if paid under:
    - Disaster Relief Act or National Flood Insurance Act
  - To protect the property from future disasters, rather than provide relief afterwards.

Example 6.7

- Flood Hazard Mitigation

ISSUE 2: DISASTER RELIEF

P. 206

Postponed Deadlines

- IRS may postpone for **up to 1 year** most tax deadlines
  - For taxpayers impacted by federally declared disaster
- **Includes:**
  - ➢ Filing all federal tax returns, including claims for refund
  - ➢ Paying income, gift, and estate taxes
  - ➢ Making contributions to a traditional IRA or Roth IRA
- **NOTE: What is not covered in the list above?**
  - Payment of employment taxes!!!

ISSUE 2: DISASTER RELIEF

P. 206

Postponed Deadlines

- General Rules
  - IRS publicizes postponed tax deadlines in affected areas
  - 2023 relief (as of July 2023) is available for taxpayers in:
    - Alabama, Arkansas, California, Georgia, Indiana, Mississippi, New York, Oklahoma, and Tennessee
  - Visit www.irs.gov/newsroom/tax-relief-in-disaster-situations for an update

Practitioner Note

- State Income Tax

ISSUE 2: DISASTER RELIEF

P. 206-207

Postponed Deadlines

- Affected taxpayers eligible for additional time to file include:
  - Individual whose principal residence is in covered disaster area (CDA)
  - Business entity or sole proprietorship whose principal place of business is in CDA
  - Individual who is a relief worker affiliated with a recognized government or philanthropic organization and who is assisting victims in CDA
  - Individual, business entity, or sole proprietorship whose records that are needed to meet a postponed deadline are maintained in CDA

ISSUE 2: DISASTER RELIEF

P. 206-207

Postponed Deadlines (Continued)

- An estate or trust that has tax records necessary to meet a postponed tax deadline provided those records are maintained in a CDA
- Spouse filing joint return with taxpayer eligible for postponement
- Any individual visiting the CDA who was killed or injured as a result of the disaster
- Any other person who the IRS determines to be affected by federally declared disaster

ISSUE 2: DISASTER RELIEF

P. 207

Postponed Deadlines

Practitioner Note

- Tax Preparer in Disaster Area
  - May qualify for relief
  - Call FEMA

ISSUE 2: DISASTER RELIEF

P. 207

Postponed Deadlines

- No requirement to "flag" a Form 1040 with disaster designation
- FEMA notified IRS of areas qualifying for individual assistance
- IRS systemically codes taxpayers accounts by the affected zip codes
- **However, use the disaster designation on top of Form 1040X!**
  - To assist IRS in processing amended returns expeditiously

ISSUE 2: DISASTER RELIEF

P. 207

Retirement Plan Distributions

- Secure 2.0 Act provides permanent rules for use of retirement funds for federally declared disaster
- Allows $20,000 distribution to affected individuals
  - Not subject to 10% additional tax on early distribution
  - Included as gross income over 3 years
  - Distributions can be repaid

ISSUE 2: DISASTER RELIEF

P. 207

- **Retirement Plan Distributions** (Continued)
- Amount distributed **prior to** disaster to purchase home
  - ➢ Can be recontributed
  - ➢ So additional amount can then be borrowed allowing additional time for repayment

ISSUE 3: DIGITAL ASSETS

P. 208

Reporting Digital Assets (f.k.a. Virtual Currencies)

- Form 1040, Page 1, Question
  - At any item 2022 did you receive (as a reward, award, or payment for property or services); or sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?
- Form 1040 Instructions for question was expanded and clarified

ISSUE 3: DIGITAL ASSETS

P. 208

Reporting Digital Assets (aka Virtual Currencies)

- Form 1040, Page 1, Question – Check the box "Yes" if the taxpayer:
  - Received digital assets as
    - Payment for property or services provided
    - Result of a reward or award
    - Result of mining, staking, and similar activities
    - Result of a hard fork

ISSUE 3: DIGITAL ASSETS

P. 208

Reporting Digital Assets (aka Virtual Currencies)

- Form 1040, Page 1, Question – Check the box "Yes" if the taxpayer:
  - Disposed of digital assets
    - In exchange for property or service
    - In exchange or trade for another digital asset
  - Sold a digital asset
  - Transferred digital assets for free as a bona fide gift or otherwise exposed of any other financial interest in a digital asset

ISSUE 3: DIGITAL ASSETS

P. 208

Reporting Digital Assets

Taxpayer **has** a financial interest in a digital asset if taxpayer:

- Is owner of record of a digital asset
- Has an ownership stake in an account that holds one or more digital assets
  - Including the rights and obligations to acquire a financial interest
- Owns a wallet that holds digital assets

ISSUE 3: DIGITAL ASSETS

P. 208-209

Reporting Digital Assets Taxpayer can check "No" if:

- Merely owned digital assets during the year
  - Did not engage in any transactions involving digital assets during the year
- Activities were limited to one or more of the following:
  - Holding a digital asset in a wallet or account
  - Transferring a digital asset from one wallet/account the taxpayer owns or controls to another
  - Purchasing digital assets using US or other real currency, including through electronic platforms such as PayPal or Venmo

ISSUE 3: DIGITAL ASSETS

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Reporting Digital Asset Income

- If, in 2023, the taxpayer disposes of any digital asset held as a capital asset
  - Through sale, trade, exchange, payment, gift, or other transfer, the taxpayer must check "Yes" box and report the transactions on:
    - **Form 8949**
      - *Sales and other Dispositions of Capital Assets*
        - Calculate capital gain or loss & report on Schedule D (Form 1040)
    - **Form 709**
      - *US Gift Tax Return*

ISSUE 3: DIGITAL ASSETS

P. 209

Reporting Digital Asset Income

- Received digital asset as compensation for services
- Disposed of digital asset that was held for sale to Customers
  - Report income like other income of the same type

Practitioner Note

- IRS delays Cryptocurrency Reporting

ISSUE 3: DIGITAL ASSETS

P. 209

No Loss Deduction for Decline in Value

- **C.C.A. 202302011 (January 10, 2023)**
  - IRS Chief Counsel considered the applicability of I.R.C. 165 to crypto that declined in value
    - Taxpayer purchased crypto for personal investment in 2022 at $ 1.00 per unit
    - Value decreased significantly (valued less than 1 cent at end of 2022)
    - The crypto was still traded on at least one crypto exchange
    - Taxpayer maintained ability to sell, exchange, or transfer the units
    - Taxpayer claimed a loss deduction on 2022 return and took position that units were worthless or abandoned

ISSUE 3: DIGITAL ASSETS

P. 210

No Loss Deduction for Decline in Value

- **C.C.A. 202302011 (January 10, 2023)**
  - Section 165 provides for the deduction of losses (not compensated by insurance)
  - Loss is allowed as a deduction only for the tax year in which the loss is sustained
  - Loss is treated as sustained during the tax year in which the loss occurs as evidenced
    - By closed and completed transactions, and
    - As fixed by identifiable events occurring in such tax year
  - Deductible as miscellaneous itemized deduction

ISSUE 3: DIGITAL ASSETS

P. 210

No Loss Deduction for Decline in Value

Practitioner Notes

- Miscellaneous Itemized Deduction
  - I.R.C. § 165(a) losses (other than casualty, theft, and wagering) are characterized as miscellaneous itemized deductions
- Under current law
  - I.R.C. § 67(g) disallows ALL miscellaneous itemized deductions
    - Tax years 2018 through 2025

ISSUE 3: DIGITAL ASSETS

P. 210

No Loss Deduction for Decline in Value

- **Loss Due to Worthlessness**
  - If any security that is a capital asset becomes worthless during the tax year
    - Loss is treated as a loss from the sale or exchange of a capital asset
  - Cryptocurrency is **NOT** a security and section 165(g) does not apply

ISSUE 3: DIGITAL ASSETS

P. 210

No Loss Deduction for Decline in Value

- **Loss Due to Worthlessness**
  - Per the C.C.A. Memo:
    - *The mere decrease in value of property did not create a deductible loss*
      - ➢ Each unit of crypto had liquidating value (though only 1 cent)
      - ➢ Still traded on crypto exchange, allowing for possibility of increase in value
      - ➢ Therefore, as not wholly worthless, the taxpayer did not sustain a bona fide loss

ISSUE 3: DIGITAL ASSETS

P. 210

No Loss Deduction for Decline in Value

- **Loss Due to Abandonment**
  - A taxpayer sustains a loss under section165(a) for the obsolescence or loss of usefulness of nondepreciable property if
    - Loss is incurred in a business or transaction entered into profit
    - Loss arises from sudden termination of usefulness in the business or transaction
    - Property is permanently discarded from use, or the transaction is discontinued

ISSUE 3: DIGITAL ASSETS

P. 210

No Loss Deduction for Decline in Value

- **Loss Due to Abandonment**
  - Per the C.C.A. Memo:
    - *The taxpayer did not take any action to abandon and permanently discard the units of crypto in 2022*
      - ➢ Taxpayer continued to own the crypto
      - ➢ Retained ability to sell, exchange, or otherwise dispose of it
      - ➢ Therefore, the taxpayer did not sustain a loss due to abandonment

ISSUE 3: DIGITAL ASSETS

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Charitable Contribution of Cryptocurrency

- **C.C.A. 202302011 (January 10, 2023)**
  - Must a taxpayer obtain a qualified appraisal for contributions of crypto for which the taxpayer claimed a charitable contribution deduction for more than $5,000?
    - ➢ Taxpayer purchased crypto for personal investment
    - ➢ Later transferred all the units to a charitable organization
    - ➢ Completed Part I, Section B, Form 8283
    - ➢ Claimed $10,000 charitable contribution deduction (based on value listed at crypto exchange on date/time of donation
    - ➢ Did not obtain, or attempt to obtain, a qualified appraisal

ISSUE 3: DIGITAL ASSETS

P. 211

Charitable Contribution of Cryptocurrency

- **C.C.A. 202302011 (January 10, 2023)**
  - Qualified appraisals are not required for donations of certain readily valued property
    - Cash, stock in trade, inventory, property held primarily for sale to customers in the ordinary course of business, publicly traded securities, intellectual property, and certain vehicles
  - Cryptocurrency is **NOT** cash nor a security
  - *Therefore, there is no exception to the qualified appraisal requirements*

ISSUE 3: DIGITAL ASSETS

P. 211-212

- **Nonfungible Tokens**
  - Treasury Department and IRS announced they are soliciting feedback regarding tax treatment of a nonfungible taken (NFT) as a collectible
  - Until additional guidance is issued
    - IRS to determine when an NFT is treated as a collectible using a **look-through analysis**
      - Ex: A gem is a collectible; therefore, a NFT that certifies ownership of a gem is a collectible

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 213

I.R.C. § **63(h)(2)(D)**

- Allows a deduction for *qualified residence interest*
  - Interest paid or accrued on the acquisition indebtedness of a qualified personal residence
- Mortgage interest rates remained high in 2023
  - More taxpayers may be able to itemize as a result

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 213

Qualified Loan Limits

- Acquisition Indebtedness
  - Debt incurred for **acquiring, constructing, or substantially improving** any qualified residence of the taxpayer, that is **secured** by the residence
  - Refinancing of such indebtedness
    - *To extent that refinancing does not exceed the amount of the refinanced indebtedness*

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 213

Qualified Loan Limits

- Prior to 2018 and after 2025
  - Acquisition Indebtedness
    - Cannot exceed $1,000,000 ($500,000 MFS)
  - Home equity indebtedness
    - Cannot exceed $100,000 ($50,000 MFS)

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 213

Qualified Loan Limits

- For tax years 2018 thru 2025 (TCJA) further limitations
  - Acquisition indebtedness cannot exceed $750,000 ($375,000 MFS)
    - Reduced limitations do **NOT** apply for debt incurred on or before 12-15-2017

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION P. 213

- Reduced limitations do **NOT** apply if taxpayer
  - Entered a binding contract by **01-01-2018** AND
  - Purchased the qualified residence by **04-01-2018**
- No deduction for home equity indebtedness unless the funds are used to buy, build, or substantially improve the taxpayer's home that secure the loan

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 214

Qualified Residence

- Taxpayer’s principal residence and one other residence of the taxpayer
  - Generally, includes:
    - House
    - Condominium
    - Mobile home
    - Boat
    - House trailer that contains sleeping space, toilet, and cooking facilities
    - House under construction that later becomes a qualified residence

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 214

Qualified Residence

- Claiming home mortgage interest deduction for second residence
  - Used by taxpayer as a residence OR
  - Not used by taxpayer as a residence if not rented at any time during tax year

Example 6.8

- Divorcing Spouse Claims Principal and Second Residence Deductions

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION PP. 214-215

Secured Debt

- **Defined**
  - Debt that is secured by any instrument (such as mortgage, deed of trust, or land contract) and the debt instrument
    - Makes the interest of the debtor in the qualified residence specific security for the payment of the debt
    - States that, in the event of default, the residence could be subjected to the satisfaction of the debt with the same priority as a mortgage or deed of trust
    - Is recorded, where permitted, with applicable state law

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION P. 215

Third Party Loan

- **Courts consider following factors to determine equitable interest:**
  - Who has right to possess the property and enjoy the use, rental income, and profits?
  - Who is responsible for maintaining the property?
  - Who is responsible for insuring the property?
  - Who bears the risks of loss?
  - Who is obligated to pay taxes, assessments, and charges against the property?
  - Can the taxpayer improve the property without permission from owner of record?
  - Can the taxpayer obtain legal title by paying the balance of the purchase price?
- *Blanche v. Commissioner,* T.C. Memo. 2001-63

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION PP. 215-216

Example 6.9

- Third Party Borrower – Equitable Ownership

Practitioner Note

- Contract for Deed

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION P. 216

Average Mortgage Balance

- Average of First & Last Balance Method
  - Adds mortgage balance on the **first day of the year** and on the **last day of the year**
  - Divide the sum by two
- Use this method if taxpayer:
  - Did not borrow any new amounts on the mortgage during the year
  - Did not prepay more than 1 month's principal during the year
  - Made level payments at fixed equal intervals on at least a semi-annual basis

Example 6.11 - Pages 216-219

- Average of First and Last Balance Method

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 220

Average Mortgage Balance

- Interest Paid Divided by Interest Rate Method
- Use this method if taxpayer:
  - Mortgage secured by taxpayer's qualified home (at all time during year)
  - Taxpayer paid interest at least monthly

Example 6.12

- Interest Paid Divided by Interest Rate Method

Practitioner Note

- Mixed-Use Mortgages

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 220

Reverse Mortgage

- Loan where lender pays the taxpayer
  - Lump sum, a monthly advance, a line of credit, or combination of all three
- Taxpayer continues to live in his or her home
  - Taxpayer retains title
  - Interest accrues, but no payments owed
  - Debt increases and equity decreases as interest is added to the monthly balance

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION P. 220

Reverse Mortgage

- Reverse mortgage (with interest) becomes due when
  - Moves, sells the home, reaches the end of the loan term, or dies
- Interest is considered home equity indebtedness
  - Remember, only deductible 2023-2025 if proceeds used to buy, build, or substantially improve home

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION P. 220-221

Form 1098 Reporting Issues

- Be aware when reported interest on Form 1098 does not match deductible interest
  - Total loan balance (reported on all Forms 1098 and unreported amounts) exceeds the applicable amounts
  - Loan is a mixed-use-loan, and a portion of the reported interest paid is, for example, not acquisition indebtedness
  - Interest paid is not reported
  - There is more than one borrower

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Form 1098 Reporting Issues

- Interest **Not** Reported on Form 1098
  - Lender is not in trade or business of lending
    - Interest paid is still deductible!
    - Report on Schedule A (Form 1040), Line 8b
    - Enter seller's name, address, and TIN on dotted line

ISSUE 4: HOME MORTGAGE INTEREST DEDUCTION

P. 221

Form 1098 Reporting Issues

- More Than One Borrower
  - Attached a statement explaining the reporting
    - How much interest **each** owner paid
    - Provide name and address of the person who received Form 1098
  - Deduct appropriate share of interest on Schedule A (Form 1040), Line 8b
  - Print “See attached” next to Line 8b


WAAAT