Pearsons Federal Taxation 2019 Individuals 32nd edition Pope Test Bank

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Pearson's Federal Taxation 2019: Comprehensive, 32e **(Rupert/Anderson)**
Chapter I2: Determination of Tax

LO1: Formula for Individual Income Tax

1) The term "gross income" means the total of all income from any source, but after reduction for exclusions.
Answer: TRUE
Explanation: The tax law includes all sources of income in gross income unless specifically excluded.
Page Ref.: I:12-3
Objective: 1

2) Although exclusions are usually not reported on an individual's income tax return, interest income on state and local government bonds must be reported on the tax return.
Answer: TRUE
Explanation: See Additional Comment, p. I:2-3.
Page Ref.: I:2-3
Objective: 1

3) Generally, deductions for (not from) adjusted gross income are personal expenses specifically allowed by tax law.
Answer: FALSE
Explanation: Personal expenses, if deductible, are generally from AGI deductions.
Page Ref.: I:2-4
Objective: 1

4) Generally, itemized deductions are personal expenses specifically allowed by the tax law.
Answer: TRUE
Explanation: Personal expenses are not allowed as deductions unless specifically provided in the tax law.
Page Ref.: I:2-4
Objective: 1

5) Taxpayers have the choice of claiming either deductions for AGI or the standard deduction.
Answer: FALSE
Explanation: All taxpayers are allowed to deduct their qualifying deductions for AGI. In addition, taxpayers have the choice of claiming either itemized deductions or the standard deduction as deductions from AGI.
Page Ref.: I:12-5
Objective: 1

6) Refundable tax credits are allowed to reduce or totally eliminate a taxpayer's tax liability but any credits in excess of the tax liability are lost.
Answer: FALSE
Explanation: Refundable tax credits may reduce the tax liability to zero and, if some credit still remains, are refundable or paid by the government to the taxpayer.
Page Ref.: I:2-6
Objective: 1

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7) Nonrefundable tax credits are allowed to reduce or totally eliminate a taxpayer's tax liability but any credits in excess of the tax liability are lost.
Answer: TRUE
Explanation: Nonrefundable credits can only reduce the tax liability to zero. The excess is lost.
Page Ref.: I:2-6
Objective: 1

8) Taxable income for an individual is defined as
A) AGI reduced by itemized deductions and tax credits.
B) gross income reduced by itemized deductions.
C) AGI reduced by tax credits.
D) AGI reduced by the greater of the standard deduction or itemized deductions.
Answer: D
Explanation: Taxable income is AGI reduced by either the standard deduction or itemized deductions.
Page Ref.: I:2-2; Table I:2-1
Objective: 1

9) All of the following items are generally excluded from income except
A) child support payments.
B) interest on corporate bonds.
C) interest on state and local government bonds.
D) life insurance proceeds paid by reason of death.
Answer: B
Explanation: Interest on corporate bonds is taxable.
Page Ref.: I:2-3; Table I:2-2
Objective: 1

10) All of the following items are included in gross income except
A) pension benefits received.
B) rent income.
C) interest earned on a bank account.
D) child support payments received.
Answer: D
Explanation: Child support is not taxable.
Page Ref.: I:2-3 and I:2-4, Tables I:2-2 and I:2-3
Objective: 1

11) All of the following items are deductions for adjusted gross income except
A) charitable contributions made.
B) trade or business expenses.
C) rent and royalty expenses.
D) state and local income taxes.
Answer: D
Explanation: State and local income taxes are itemized deductions.
Page Ref.: I:2-5; Table I:2-4
Objective: 1

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12) All of the following items are deductions for adjusted gross income except
A) interest on student loans.
B) unreimbursed employee business expenses.
C) qualifying contributions to individual retirement accounts.
D) one-half of self-employment taxes on year's earnings.
Answer: B
Explanation: Unreimbursed employee business expenses are not allowed as a deduction.
Page Ref.: I:2-5; Table I:2-4
Objective: 1

13) Which of the following credits is considered a refundable credit?
A) credit for elderly and disabled
B) earned income credit
C) adoption expense credit
D) lifetime learning credit
Answer: B
Explanation: The earned income credit is a refundable credit.
Page Ref.: I:2-6; Table I:2-5
Objective: 1

14) A single taxpayer provided the following information for 2018:

Salary	$80,000
Interest on local government bonds (qualifies as a tax exclusion)	4,000
Allowable itemized deductions	13,000

What is taxable income?
A) $71,000
B) $62,950
C) $80,000
D) $67,000
Answer: D
Explanation: $80,000 - $13,000 itemized deductions = $67,000
Page Ref.: I:2-6; Example I:2-1
Objective: 1

15) Hannah is single with no dependents and has a salary of $102,000 for 2018, along with tax exempt interest income of $3,000 from a municipality. Her itemized deductions total $12,600.

Required: Compute her taxable income.
Answer: Salary $102,000
(Interest income is excluded)
Less:
Itemized deductions (12,600)
Taxable income $ 89,400
Page Ref.: I:2-3 through I:2-7; Example I:2-1
Objective: 1

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16) Kadeisha is single with no dependents and has a salary of $102,000 for 2018, along with tax exempt interest income of $3,000 from a municipality. Her itemized deductions total $11,600.

Required: Compute her taxable income.

Answer: Salary	$102,000
(Interest income is excluded)	
Less:	
Standard deduction	(12,000)
Taxable income	$ 90,000

Page Ref.: I:2-3 through I:2-7; Example I:2-1
Objective: 1

17) The following information is available for Bob and Brenda Horton, a married couple filing a joint return, for 2018. Both Bob and Brenda are age 32 and have no dependents.

Salaries	$200,000
Interest income	12,000
Deductible IRA contributions	11,000
Itemized deductions	25,600
Withholding	31,000

a. What is the amount of their gross income?
b. What is the amount of their adjusted gross income?
c. What is the amount of their taxable income?
d. What is the amount of their tax liability (gross tax), rounded to the nearest dollar?
e. What is the amount of their tax due or (refund due)?

Answer:	**Hortons**	
Salary	$200,000	
Interest	12,000	
Gross Income	**$212,000**	**a.**
Minus: IRA Contributions	11,000	
Adjusted gross income	**$201,000**	**b.**
Minus: Itemized deductions	(25,600)	
Taxable Income	**$175,400**	**c.**
Tax liability (using Rate Schedule) *	**$30,675**	**d.**
Minus: Withholding	- 31,000	
Tax due (refund)	**($ 325)**	**e.**

*$28,179 + [.24 (175,400 - 165,000)]
Page Ref.: I:2-3 through I:2-7; Example I:2-1
Objective: 1

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LO2: Deductions from Adjusted Gross Income

1) The standard deduction is the maximum amount of itemized deductions which may be claimed by a taxpayer and is based on an individual's filing status, age, and vision.
Answer: FALSE
Explanation: The standard deduction, set by Congress, is not directly related to itemized deductions. It is the alternative to itemized deductions.
Page Ref.: I:2-10
Objective: 2

2) Nonresident aliens are allowed a full standard deduction.
Answer: FALSE
Explanation: The standard deduction is not available to nonresident aliens.
Page Ref.: I:2-10 and I:2-11
Objective: 2

3) The standard deduction may not be claimed by one married taxpayer filing a separate return if the other spouse itemizes deductions.
Answer: TRUE
Explanation: If a married couple files separately and one spouse itemized deductions, the other spouse must also itemize.
Page Ref.: I:2-10 and I:2-11
Objective: 2

4) A qualifying child of the taxpayer must meet the gross income test.
Answer: FALSE
Explanation: The gross income test only applies to potential dependents who are not a qualifying child of the taxpayer.
Page Ref.: I:2-12 and I:2-13
Objective: 2

5) For purposes of the dependency exemption, a qualifying child must be under age 19, a full-time student under age 24, or a permanently and totally disabled child.
Answer: TRUE
Explanation: Two primary considerations for qualifying child status are age and full-time student status. In addition, an otherwise eligible individual may qualify.
Page Ref.: I:2-12 and I:2-13
Objective: 2

6) For purposes of the dependency criteria, a qualifying child may not provide more than one-half of his or her own support during the year.
Answer: TRUE
Explanation: An otherwise qualifying child will no longer qualify if he provides more than half of his own support.
Page Ref.: I:2-12 and I:2-13
Objective: 2

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7) Parents must provide more than half the support of their child under the age of 19 in order for the child to be considered as a dependent *qualifying child*.
Answer: FALSE
Explanation: The key support criteria for *qualifying child* status is that the child cannot provide more than half of her own support.
Page Ref.: I:2-12 and I:2-13
Objective: 2

8) A daughter or son may not satisfy the criteria to be considered a qualifying child but may still qualify as a dependent.
Answer: TRUE
Explanation: A son or daughter, or certain other family members, may exceed the age 19 or age 24 and full-time student status but may still be a dependent based on the qualifying relative criteria.
Page Ref.: I:2-13 and I:12-14
Objective: 2

9) One requirement for claiming a dependent as a qualifying relative is that the taxpayer provides more than 50 percent of the dependent's support (assuming it is not a multiple support agreement situation).
Answer: TRUE
Explanation: If an individual does not qualify as a child, a key test is whether the taxpayer provides more than half of the individual's support.
Page Ref.: I:2-15
Objective: 2

10) When two or more people qualify to claim the same person as a dependent, a taxpayer who is entitled to the exemption through the qualified child rules has priority over a taxpayer who meets the requirements for other relatives.
Answer: TRUE
Explanation: Tie-breaker rules favor the taxpayer who can claim the dependent under the qualifying child rules.
Page Ref.: I:2-16 and I:2-17
Objective: 2

11) The person claiming a dependent under a multiple support declaration must provide more than 25% of the dependent's support.
Answer: FALSE
Explanation: The minimum support percentage for a person claiming the dependent under the multiple support agreement is 10%.
Page Ref.: I:2-16 and I:2-17
Objective: 2

12) Generally, in the case of a divorced couple, the parent who has physical custody of a child for the greater part of the year is entitled to claim the child as a dependent.
Answer: TRUE
Explanation: The custodial parent will claim the child as a dependent unless a parental release is signed.
Page Ref.: I:2-18
Objective: 2

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13) A child credit is a partially refundable credit.
Answer: TRUE
Explanation: Generally, the refundable credit is limited to the lesser of (1) 15% of the taxpayer's earned income in excess of $2,500 or (2) $1,400 (if the taxpayer has one or two qualifying children).
Page Ref.: I:2-19
Objective: 2

14) In 2018, the standard deduction for a married taxpayer filing a joint return and who is 67 years old with a spouse who is 65 years old is
A) $25,300.
B) $27,200.
C) $26,600.
D) $24,000.
Answer: C
Explanation: ($26,600 = $24,000 + $1,300 + $1,300)
Page Ref.: I:2-10 and I:2-11
Objective: 2

15) In 2018, Brett and Lashana (both 50 years old) file a joint tax return claiming as a dependent their son who is blind. Their standard deduction is
A) $24,000.
B) $25,300.
C) $25,600.
D) $13,600.
Answer: A
Explanation: Blindness of a dependent does not increase the standard deduction of the taxpayers.
Page Ref.: I:2-10 and I:2-11
Objective: 2

16) Annisa, who is 28 and single, has adjusted gross income of $55,000, itemized deductions of $5,000 and a lifetime learning credit of $1,000. In 2018, Annisa will have taxable income of
A) $43,000.
B) $55,000.
C) $50,000.
D) $42,000.
Answer: A
Explanation:

Adjusted gross income	$55,000
Minus: Standard deduction	(12,000)
Taxable income	$43,000

Page Ref.: I:2-11; Example I:2-4
Objective: 2

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17) On June 1, 2018, Ellen turned 65. Ellen has been a widow for five years and has no dependents. Her standard deduction is
A) $25,300.
B) $24,000.
C) $13,600.
D) $12,000.
Answer: C
Explanation: $12,000 + $1,600 = $13,600
Page Ref.: I:2-10 and I:2-11
Objective: 2

18) Taquin, age 67 and single, paid home mortgage interest of $5,000, charitable contributions of $5,000 and property taxes of $4,000 in 2018. He has no dependents. In addition to the personal exemption, Taquin will claim a deduction from AGI of
A) $13,600.
B) $15,600.
C) $15,300.
D) $14,000.
Answer: D
Explanation: The $1,600 deduction supplement for age or blindness only increases the standard deduction amount, not the itemized deductions allowed. In this case the increased standard deduction of $13,600 ($12,000 + $1,600) is less than the total itemized deductions of $14,000.
Page Ref.: I:2-10 and I:2-11
Objective: 2

19) The regular standard deduction is available to which one of the following taxpayers?
A) a married taxpayer filing a separate return where the other spouse itemizes
B) a person who has only unearned income and is a dependent of another
C) a nonresident alien
D) None of the above.
Answer: D
Explanation: Responses A through C are all examples of taxpayers who do not have the privilege of deducting the full standard deduction.
Page Ref.: I:2-11 and I:2-12
Objective: 2

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20) Husband and wife, who live in a common law state, are eligible to file a joint return for 2018, but elect to file separately. Wife has adjusted gross income of $25,000 and has $2,200 of expenditures which qualify as itemized deductions. Husband deducts itemized deductions of $14,200. What is the taxable income for the wife?
A) $13,000
B) $22,800
C) $25,000
D) None of the above.
Answer: B
Explanation: If one spouse on married filing separately returns itemizes deductions, the other spouse must also do so.

Income of wife	$25,000
Minus: Itemized deductions	(2,200)
Taxable Income	$22,800

Page Ref.: I:2-12; Example I:2-5
Objective: 2

21) Lewis, who is single, is claimed as a dependent by his parents. He received $2,000 during the year in dividends, which was his only income. What is his standard deduction for 2018?
A) $1,050
B) $2,000
C) $2,350
D) $12,000
Answer: A
Explanation: For a dependent, the standard deduction is the greater of earned income plus $350 or $1,050. Dividends are unearned income.
Page Ref.: I:2-12; Example I:2-6
Objective: 2

22) Charlie is claimed as a dependent by his parents in 2018. He received $8,000 during the year from a part-time acting job, which was his only income. What is his standard deduction?
A) $1,050
B) $12,000
C) $8,000
D) $8,350
Answer: D
Explanation: For a dependent, the standard deduction is the greater of earned income plus $350 or $1,050, but no more than the current year regular standard deduction amount.
Page Ref.: I:2-12; Example I:2-7
Objective: 2

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23) Deborah is claimed as a dependent by her parents. She had a part-time acting job during 2018 and earned $13,000 during the year, which was her only income. What is her standard deduction?
A) $13,000
B) $1,050
C) $12,000
D) $13,350
Answer: C
Explanation: For a dependent, the standard deduction is the greater of earned income plus $350 or $1,050, but no more than the current year regular standard deduction amount.
Page Ref.: I:2-12; Example I:2-7
Objective: 2

24) Cheryl is claimed as a dependent by her parents. She had a part-time job during 2018 and earned $4,900 during the year, in addition to $600 of interest income. What is her standard deduction?
A) $1,050
B) $4,900
C) $5,250
D) $12,000
Answer: C
Explanation: For a dependent, the standard deduction is the greater of earned income plus $350 or $1,050, but no more than the current year regular standard deduction amount.
Page Ref.: I:2-12; Example I:2-7
Objective: 2

25) Ben, age 67, and Karla, age 58, have two children who live with them and for whom they provide total support. Their daughter is 21 years old, blind, is not a full-time student and has no income. Her twin brother is 21 years old, has good sight, is a full-time student and has income of $4,800. Which of the following statements is correct regarding Ben and Karla's ability to claim the twins as dependents?
A) The couple can claim both twins as dependents.
B) The couple cannot claim either twin as a dependent.
C) The couple can only claim the daughter as a dependent.
D) The couple can only claim the son as a dependent.
Answer: A
Explanation: Although their daughter is not their qualifying child, she still qualifies as a dependent since she meets all of the dependency tests for a qualifying relative. Their son qualifies as their dependent as he is their qualifying child and need not meet the gross income test. Therefore, they are entitled to both twins as dependents.
Page Ref.: I:2-13 and I:12-14
Objective: 2

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26) Sarah, who is single, maintains a home in which she, her 15-year-old brother, and her 21-year-old niece live. Sarah provides the majority of the support for her brother, her niece, and her cousin, age 18, who is enrolled full-time at the university and lives in an apartment. While the niece and cousin have no income, her brother has a part-time job and earns $4,500 per year. How many dependents may Sarah claim?
A) 1
B) 2
C) 3
D) None
Answer: B
Explanation: Sarah may claim her niece and brother as dependents. Because her brother qualifies as her qualifying child for purposes of the dependency exemption, he does not have to meet the gross income test. Sarah may not claim her cousin as a dependent since her cousin does not live with her.
Page Ref.: I:2-13 and I:12-14
Objective: 2

27) Anita, who is divorced, maintains a home in which she and her 16-year-old daughter live. Anita provides the majority of the support for her daughter and for a son, age 23, who is enrolled part-time at the university and lives in the dorm. The son also works in the campus bookstore and earns spending money of $4,500. Which of the following statements is correct regarding the number of dependents Anita can claim?
A) Anita can claim her daughter, but not her son, as a dependent.
B) Anita can claim her son, but not her daughter, as a dependent.
C) Both the son and daughter qualify as Anita's dependents.
D) Neither the daughter nor the son qualify as Anita's dependent.
Answer: A
Explanation: Anita will claim her daughter who is a qualifying child. Anita's son does not qualify as her qualifying child because he fails the age test. He cannot qualify as her dependent under the general provisions because he fails the gross income test.
Page Ref.: I:2-13 and I:12-14
Objective: 2

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28) John supports Kevin, his cousin, who lived with him throughout 2018. John also supports three other individuals who do not live with him:

Donna, who is John's mother
Melissa, who John's stepsister
Morris, who is Kevin's brother

Assume that Donna, Melissa, Morris, and Kevin each earn less than $4,150. How many dependents can John claim?
A) 1
B) 2
C) 3
D) 4
Answer: C
Explanation: John can claim three dependents—Kevin, Donna, and Melissa. Morris is John's cousin and does not qualify as a dependent since he doesn't live in John's home. A cousin is not related for tax purposes and would have to live in the taxpayer's home to be claimed as a dependent.
Page Ref.: I:2-13 and I:12-14
Objective: 2

29) Julia provides more than 50 percent of the support for three individuals: Theresa, an unrelated child who lives with Julia all year long; Margaret, Julia's cousin, who lives in another city; and Emma, Julia's daughter, who lives in her own home. Each of the potential dependents earned less than $4,150. How many dependents can Julia claim?
A) 0
B) 1
C) 2
D) 3
Answer: C
Explanation: (Theresa, Emma) Assuming all other tests are met, Theresa qualifies as Julia's dependent. A person who lives with the taxpayer all year long need not be related to the taxpayer. Margaret does not qualify as Julia's dependent. She is not related for tax purposes and, therefore, can't be Julia's dependent unless she lives with Julia all year long. Emma qualifies as Julia's dependent. Since Emma is Julia's daughter, she is related for tax purposes and need not live with Julia to be claimed as Julia's dependent. Therefore, Julia has two dependents.
Page Ref.: I:2-13 and I:2-14; Example I:2-9
Objective: 2

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30) David's father is retired and receives $14,000 per year in Social Security benefits. David's father saves $4,000 of the benefits and spends the remaining $10,000 for his support. How much support must David provide for his father to meet the dependent support requirement?
A) $10,000
B) $10,001
C) $14,000
D) $14,001
Answer: B
Explanation: The amount that David's father saves is not counted in the support test. Therefore, David need only provide $1 more than his father ($10,000 + $1) to meet the more than 50 percent test.
Page Ref.: I:2-15; Example I:2-13
Objective: 2

31) Which of the following is not considered support for the dependent support test?
A) food
B) clothing
C) rental value of lodging
D) value of services rendered by the taxpayer for the dependent
Answer: D
Explanation: Food, clothing, and the rental value of the lodging are all considered support.
Page Ref.: I:2-15
Objective: 2

32) Juanita's mother lives with her. Juanita purchased clothing for her mother costing $1,000 and provided her with a room that Juanita estimates she could have rented for $4,000. Juanita spent $5,000 on groceries she shared with her mother. Juanita also paid $700 for her mother's health insurance coverage. How much of these costs is considered support?
A) $5,000
B) $8,200
C) $10,000
D) $10,700
Answer: B
Explanation: $1,000 + 4,000 + 700 + .5(5,000) = $8,200
Page Ref.: I:2-15; Example I:2-14
Objective: 2

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33) Anna is supported entirely by her three sons John, James, and Joseph who provide for her support in the following percentages:

John: 10%, James: 40%, Joseph: 50%

Assuming a multiple support declaration exists, which of the brothers may claim his mother as a dependent?
A) any of the sons
B) James or Joseph
C) Joseph only
D) None of them.
Answer: B
Explanation: Although no one provides more than 50 percent of Anna's support, a qualifying pool of individuals (John, James, and Joseph) provide over 50 percent of Anna's support. Any one of them who provides more than 10 percent (James or Joseph) may claim Anna, assuming a multiple support agreement is filed.
Page Ref.: I:2-16 and I:2-17; Example I:2-17
Objective: 2

34) Blaine Greer lives alone. His support comes from the following sources:

Buddy (his son)	$2,600
Ken (his brother)	4,200
Martha (his daughter)	2,300
Natalie (a friend)	1,000
Total support	$10,100

Assuming a multiple support declaration exists, which of the individuals may claim Blaine as a dependent?
A) Ken or Martha
B) Buddy, Ken, or Martha
C) Ken, Martha, or Natalie
D) None of them.
Answer: B
Explanation: A qualifying pool of individuals (Buddy, Ken, and Martha) provides more than 50 percent of Blaine's support. Natalie is not part of the qualifying pool as she could not otherwise claim Blaine because he is not related to her and does not live in her home. Of the qualifying pool, any individual who provides more than 10 percent of Blaine's support (Buddy, Ken, or Martha) may claim Blaine under a multiple support agreement.
Page Ref.: I:2-16 and I:2-17; Example I:2-17
Objective: 2

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35) The child credit is for taxpayers with dependent children under the age of
A) 14.
B) 17.
C) 19.
D) 24.
Answer: B
Explanation: Children must be under age 17 to qualify.
Page Ref.: I:2-18
Objective: 2

36) Steven and Susie Tyler have three children ages 13, 15, and 19. The 19-year-old is in the military and not a dependent. Their modified AGI is $108,000. What is the amount of the child credit to which they are entitled?
A) $0
B) $2,000
C) $4,000
D) $6,000
Answer: C
Explanation: 2 × $2,000 = $2,000. The 19-year-old will not qualify for the credit.
Page Ref.: I:2-18 and I:2-19
Objective: 2

37) Nate and Nikki have two dependent children ages 12 and 15. Their modified AGI is $410,000. What is the amount of the child credit to which they are entitled?
A) $0
B) $500
C) $3,500
D) $4,000
Answer: C
Explanation: The child credit before the phase-out is $4,000 (2 × $2,000); the 17-year-old does not qualify. They have excess AGI of $10,000 ($410,000 - $400,000). Their credit should be reduced by 10 ($10,000/$1,000) × $50 = $500. Thus, their child credit is $3,500.
Page Ref.: I:2-18 and I:2-19; Example I:2-22
Objective: 2

38) Ryan and Edith file a joint return showing $420,000 of AGI. They have three dependent children ages 7, 9, and 13. What is the amount of their child credit?
A) $0
B) $2,000
C) $5,000
D) $6,000
Answer: C
Explanation: The child credit is $1,000 per qualifying child, with a phase-out for AGI exceeding $400,000 on joint returns. $420,000 - 400,000 = $20,000. There are twenty $1,000 increments (or parts thereof) exceeding the $400,000 phase-out floor, so the child credit will be reduced by 20 × $50 = $1,000. Credit before phase-out is 3 children × $2,000 = $6,000. After the phase-out the credit is $5,000 = $6,000 - $1,000.
Page Ref.: I:2-18 and I:2-19; Example I:2-22
Objective: 2

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39) Amanda has two dependent children, ages 10 and 12. She earned $30,000 from her job, and her income tax before credits is $1,200. How much of her child credit is refundable?
A) $1,200
B) $1,400
C) $2,800
D) $4,000
Answer: B
Explanation: The child credit earned is $4,000 ($2,000 per child), of which $1,200 will offset the income tax liability. The refundable component of the $2,800 balance is limited to $1,400: the lesser of (1) 15% of the taxpayer's earned income in excess of $2,500 (which is $4,125) or (2) $1,400.
Page Ref.: I:2-18 and I:2-19; Example I:2-25
Objective: 2

40) Steve Greene, age 66, is divorced with no dependents. In 2018, Steve had income and expenses as follows:

Gross income from salary	$80,000
Total itemized deductions	5,500

Compute Steve's taxable income for 2018. Show all calculations.

Answer: Adjusted gross income	$80,000
Less: Standard deduction ($12,000 + $1,600)	(16,600)
Taxable income	$63,400

The additional standard deduction is for Steve's age.
Page Ref.: I:2-10 and I:2-11
Objective: 2

41) Sean and Martha are both over age 65 and Martha is considered blind by tax law standards. Their total income in 2018 from part-time jobs and interest income from a bank savings account is $80,000. Their itemized deductions are $25,000.

Required: Compute their taxable income.

Answer: Salary & interest	$60,000
Less:	
Standard deduction [$24,000 + (3 × 1,300)]	(27,900)
Taxable income	$32,100

The standard deduction is increased because of age for both and blindness for Martha.
Page Ref.: I:2-10 and I:2-11
Objective: 2

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42) Kate is single and a homeowner. In 2018, she has property taxes on her home of $4,000, pays state income taxes of $5,000, makes charitable contributions of $3,000, and pays home mortgage interest of $6,000. Kate's adjusted gross income for 2018 is $77,000.

Required: Compute her taxable income for 2018.

Answer: Adjusted gross income		$77,000
Minus: Itemized deductions:		
Property taxes	$4,000	
State income taxes	5,000	
Home mortgage interest	6,000	
Charitable contributions	3,000	(18,000)
Taxable income		$59,000

Page Ref.: I:2-11; Example I:2-3
Objective: 2

43) In 2018, Sam is single and rents an apartment for which he pays $800 per month, pays state income taxes of $2,000 and makes charitable contributions of $1,000. Sam's adjusted gross income is $47,000.

Required: Compute his taxable income. Show all calculations.

Answer: Adjusted gross income	$47,000
Minus: Standard deduction	(12,000)
Taxable income	$35,000

Page Ref.: I:2-11; Example I:2-4
Objective: 2

44) Eliza Smith's father, Victor, lives with Eliza who is a single taxpayer. During the year, Eliza purchased clothing for her father costing $1,200 and provided him with a room that could have been rented for $6,000. In addition, Eliza spent $4,000 for groceries she shared with her father. Eliza purchased a new computer for $900 which she placed in the living room for both her father and her use.

What is the amount of support provided by Eliza to her father?

Answer: Clothing	$1,200
Rental value of room	6,000
Groceries (1/2 × $4,000)	2,000
Total support	$9,200

Page Ref.: I:2-15; Example I:2-14
Objective: 2

45) Paul and Hannah, who are married and file a joint return, are in the process of adopting a child who is born in December 2018. The child, a son, comes to live with them a week after his birth on December 12. The adoption is not finalized until February of 2019. What tax issues are present in this situation?
Answer: Are Paul and Hannah able to claim the baby as a dependent in 2018, allowing them to claim a child tax credit?
Page Ref.: I:2-12 and I:2-13
Objective: 2

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LO3: Determining the Amount of Tax

1) A married couple need not live together to file a joint return.
Answer: TRUE
Explanation: A couple legally married at year-end can filed a joint return.
Page Ref.: I:2-20
Objective: 3

2) A widow or widower whose spouse passed away in the current year may file a joint tax return as long as the surviving spouse does not remarry before the end of the year.
Answer: TRUE
Explanation: A joint return may be filed in the year of death.
Page Ref.: I:2-21
Objective: 3

3) An unmarried taxpayer may file as head of household if he maintains a home for his qualifying child.
Answer: TRUE
Explanation: A divorced, legally separated or never married parent can file as head of household if he maintains a home for his qualifying child.
Page Ref.: I:2-22
Objective: 3

4) Theo's wife moved overseas in April, and they have not been in touch, although they are still legally married. Theo pays all the costs of the household which includes his 12-year-old son. Because Theo is still married, his only option is to file his tax return as married filing separately.
Answer: FALSE
Explanation: A married individual can claim head of household status if the taxpayer lived apart from the spouse for the last six months of the year, and the taxpayer paid over half the cost of maintaining the household with a dependent child.
Page Ref.: I:2-24
Objective: 3

5) Kelly is age 23 and a full-time student with interest and dividend income of $2,600 in the current year. The total cost of her support for the year is $19,000. She is not subject to the kiddie tax.
Answer: FALSE
Explanation: She meets the age and student status to be subject to kiddie tax, and her unearned income exceeds the $2,100 threshold.
Page Ref.: I:2-24
Objective: 3

6) Divya is age 22 and a full-time student with $8,000 of income from part-time and summer jobs and $2,600 of interest and dividend income. The total cost of her support for the year is $15,000. Divya is not subject to the kiddie tax.
Answer: TRUE
Explanation: For children between ages 19 and 23 with unearned income exceeding $2,100 in 2018, the kiddie tax will apply unless earned income exceeds half of the cost of support. Divya's earned income is more than half of the cost of her support so kiddie tax will not apply.
Page Ref.: I:2-24
Objective: 3

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7) If a 13-year-old has earned income of $500 and interest and dividends of $2,500, all of the income can be reported on the parent's return.
Answer: FALSE
Explanation: To be eligible, the child's income must come solely from interest and dividends.
Page Ref.: I:2-26
Objective: 3

8) Suri, age 8, is a dependent of her parents and has unearned income of $6,000. She must file her own tax return.
Answer: FALSE
Explanation: A dependent earning solely unearned income not exceeding $10,000 may report unearned income on the parents' return.
Page Ref.: I:2-26
Objective: 3

9) You may choose married filing jointly as your filing status if you are married and both you and your spouse agree to file a joint return. Which of the following facts would prevent you from being considered married for filing purposes?
A) You were married for several years, but your divorce became final in December.
B) You are married but living apart until some problems can be solved.
C) Your spouse died during the year.
D) None of the above.
Answer: A
Explanation: Except in the year of the death of a spouse, marital status is determined as of the last day of the tax year. If the couple is divorced in December, then they are not married for tax purposes and may not file a joint return.
Page Ref.: I:2-20
Objective: 3

10) Tom and Alice were married on December 31 of last year. What is their filing status for last year?
A) They file as single.
B) They file as married filing jointly or married filing separately.
C) They file as single for half the year and married filing jointly for the other half.
D) They file as single for 364 days and married filing jointly for one day.
Answer: B
Explanation: Marital status is determined as of the last day of the tax year. If the couple was married on December 31, they are considered married for the entire year and may file either married filing jointly or married filing separately.
Page Ref.: I:2-20
Objective: 3

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11) When a spouse dies, the surviving spouse for the year of death
A) may file a married filing jointly return.
B) must file a tax return using the single filing status.
C) must file a tax return using the head of household filing status.
D) may file a married filing jointly return only if the death occurred in the last half of the year.
Answer: A
Explanation: In the year of death, a joint return can be filed.
Page Ref.: I:2-21
Objective: 3

12) In 2015, Leo's wife died. Leo has two small children, ages 2 and 4, living at home whom he supports entirely. Leo does not remarry and is not claimed as a dependent on another's return during any of this period. In 2016, 2017, and 2018, Leo's most advantageous filing status is, respectively
A) single for all three years.
B) head of household for all three years.
C) surviving spouse, surviving spouse, head of household.
D) surviving spouse, surviving spouse, single.
Answer: C
Explanation: In the two years following year of death (2016 and 2017), Leo may file as surviving spouse as long as he has at least one dependent child living in the home during the entire year and he provides over half of the expenses of the home. After the two years following the year of death, Leo qualifies as head of household as he is unmarried and is maintaining a home for a qualifying individual (in this case, his qualifying child).
Page Ref.: I:2-21
Objective: 3

13) Edward, a widower whose wife died in 2015, maintains a household for himself and his 10-year-old daughter. Edward's most favorable filing status for 2018 is
A) single.
B) surviving spouse.
C) head of household.
D) married filing jointly.
Answer: C
Explanation: Surviving spouse status is only available for the two years following the spouse's death, in this case, 2016 and 2017. However, Edward does qualify for head of household in 2018.
Page Ref.: I:2-21
Objective: 3

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14) In order to qualify to file as surviving spouse, all of the following criteria must be met by the widow or widower except
A) he or she and the decedent must have shared the same household as of date of death.
B) he or she must be a U.S. citizen or resident.
C) he or she must be qualified to file a joint return in the year of death.
D) he or she must have at least one dependent child living at home the entire year and pay over half of the expenses of the home.
Answer: A
Explanation: There is no requirement that the surviving spouse and the deceased spouse were living in the same household as of date of death.
Page Ref.: I:2-21
Objective: 3

15) Which of the following dependent relatives does not have to live in the same household as the taxpayer who is claiming head of household filing status?
A) uncle
B) brother
C) father
D) nephew
Answer: C
Explanation: A taxpayer with a dependent parent qualifies as head of household even if the parent does not live with the taxpayer.
Page Ref.: I:2-22
Objective: 3

16) Sally divorced her husband three years ago and has not remarried. Since the divorce she has maintained her home in which she and her now sixteen-year-old daughter reside. The daughter is a qualified child. Sally signed the daughter's dependent status over to her ex-spouse by filing the appropriate IRS form. What is Sally's filing status for the current year?
A) single
B) surviving spouse
C) head of household
D) married filing separately
Answer: C
Explanation: Sally qualifies as head of household for the current year. A taxpayer with a qualifying child satisfies the head of household requirement even if the taxpayer releases the dependent status to the child's other parent.
Page Ref.: I:2-23; Example I:2-29
Objective: 3

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17) Dave, age 59 and divorced, is the sole support of his mother age 83, who is a resident of a local nursing home for the entire year. Dave's mother had no income for the year. Dave's filing status is
A) married filing separately.
B) single.
C) head of household.
D) married filing jointly.
Answer: C
Explanation: Dave's mother qualifies as his dependent. He qualifies as head of household since a taxpayer with a dependent parent qualifies even if the parent does not live with the taxpayer.
Page Ref.: I:2-22
Objective: 3

18) The filing status in which the rates increase most rapidly is
A) surviving spouse.
B) head of household.
C) married filing separately.
D) married filing jointly.
Answer: C
Explanation: The rates on the married filing separately schedule increases more rapidly than other individual rate schedules.
Page Ref.: I:2-22
Objective: 3

19) A married taxpayer may file as head of household under the abandoned spouse provisions if all of the following are met except
A) the taxpayer lived apart from his or her spouse for the last six months of the year.
B) the taxpayer is a U.S. citizen or resident.
C) the taxpayer pays over half of the cost of maintaining a household in which the taxpayer and a dependent son or daughter live for over half of the year.
D) the taxpayer must have been married for at least two years.
Answer: D
Explanation: The first three items are all required to meet the abandoned spouse definition. The requirements do not specify a minimum length of marriage.
Page Ref.: I:2-22
Objective: 3

20) To qualify as an abandoned spouse, the taxpayer is not required to
A) be a U.S. citizen or resident.
B) live apart from the spouse for the last six months of the year.
C) pay more than half the cost of maintaining the home.
D) have a son or daughter in the home for the entire year.
Answer: D
Explanation: The dependent son or daughter need only live in the taxpayer's home for more than one-half of the year.
Page Ref.: I:2-22
Objective: 3

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21) In October 2018, Joy and Paul separated and have not lived with each other since, but they are still legally married. They do not file a joint return. Joy supports their children after the separation and pays the cost of maintaining their home. Joy's filing status in 2018 and 2019 is, respectively
A) single for both years.
B) head of household and single.
C) married filing separately for both years.
D) married filing separately and head of household.
Answer: D
Explanation: Joy and Paul are married on the last day of the year so either a joint return or a separate return is required unless Joy qualifies as an abandoned spouse (and thus, head of household). She does not qualify in 2018 since Paul was in the home during the last six months of the year. However, since Paul is gone, a married filing separate return is necessary since he is not around to sign a joint return. In 2019, Joy, though still married, qualifies as an abandoned spouse and, thus, head of household.
Page Ref.: I:2-23; Examples I:2-32 and I:2-33
Objective: 3

22) The oldest age at which the "Kiddie Tax" could apply to a dependent child is
A) 17.
B) 18.
C) 20.
D) 23.
Answer: D
Explanation: The child must be under age 24.
Page Ref.: I:2-24
Objective: 3

23) Tobe is a 22-year-old college student with $5,000 of interest income and $6,000 of earned income. Kiddie tax will apply to him if
A) he is a part-time student and the cost of his support exceeds $12,000.
B) he is a part-time student and the cost of his support is $12,000 or less.
C) he is a full-time student and the cost of his support exceeds $12,000.
D) he is a full-time student and the cost of his support is $12,000 or less.
Answer: C
Explanation: Kiddie tax will apply to a full-time student between the ages of 19 through 23 with unearned income exceeding $2,100 in 2018 and whose earned income is less than or equal to one-half of his support.
Page Ref.: I:2-24
Objective: 3

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24) Elise, age 20, is a full-time college student with earned income from wages of $4,400 and interest income of $500. Elise's parents provide more than half of her support. Elise's 2018 taxable income is
A) $0.
B) $150.
C) $500.
D) $3,850.
Answer: B
Explanation:

Earned income	$4,400
Plus: Interest income	500
Adjusted gross income	$4,900
Minus: Standard deduction [$4,400 + 350 but not more than $12,000]	(4,750)
Taxable income	$ 150

Page Ref.: I:2-25; Example I:2-37
Objective: 3

25) Michelle, age 20, is a full-time college student with earned income from wages of $5,200 and interest income of $700. Michelle's parents provide more than half of Michelle's support. Michelle's 2018 taxable income is
A) $0.
B) $700.
C) $350.
D) $4,850.
Answer: C
Explanation:

Earned income	$5,200
Plus: Interest income	700
Adjusted gross income	$5,900
Minus: Standard deduction [$5,200 + 350 but not more than $12,000]	(5,550)
Taxable income	$ 350

Page Ref.: I:2-24; Example I:2-36
Objective: 3

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26) Satish, age 11, is a dependent of his parents. His only source of income in 2018 is $8,000 of interest income on bonds given him by his grandparents, resulting in taxable income of $6,950. Under kiddie tax rules, calculation of tax requires dividing taxable income between net unearned income and earned taxable income. Satish's taxable income will be divided as follows:
A) net unearned income -$6,950 and earned taxable income -$0.
B) net unearned income -$5,900 and earned taxable income -$1,050.
C) net unearned income -$0 and earned taxable income -$6,950.
D) net unearned income -$8,000 and earned taxable income -$1,050.
Answer: B
Explanation:

Unearned income	$8,000
Less: Statutory deduction	-1,050
Standard deduction	-1,050
Net unearned income	$5,900
Taxable income	$6,950
Less net unearned income	-5,900
Earned taxable income	$1,050

Page Ref.: I:2-25; Example I:2-37
Objective: 3

27) Yusef, age 15, is a dependent of his parents. In 2018 he earned $5,000 from a part-time job and $8,000 of interest income on bonds given him by his grandparents, resulting in taxable income of $7,650. Under kiddie tax rules, calculation of tax requires dividing taxable income between net unearned income and earned taxable income. Yusef's taxable income will be divided as follows:
A) net unearned income -$5,900 and earned taxable income -$1,750.
B) net unearned income -$7,650 and earned taxable income -$0.
C) net unearned income -$0 and earned taxable income -$7,650.
D) net unearned income -$1,750 and earned taxable income -$5,900.
Answer: A
Explanation:

Unearned income	$8,000
Less: Statutory deduction	-1,050
Standard deduction	-1,050
Net unearned income	$5,900
Taxable income	$7,650
Less net unearned income	-5,900
Earned taxable income	$1,750

Page Ref.: I:2-25; Example I:2-37
Objective: 3

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28) The following information for 2018 relates to Emma Grace, a single taxpayer, age 18:

Salary	$6,500
Interest income	1,200
Itemized deductions	500

a. Compute Emma Grace's taxable income assuming she is self-supporting.
b. Compute Emma Grace's taxable income assuming she is a dependent of her parents.
Answer:
a.

Salary	$ 6,500
Interest	1,200
Adjusted gross income	$7,700
Minus: Standard deduction	(12,000)
Taxable income	0

b.

Salary	$ 6,500
Interest	1,200
Adjusted gross income	$ 7,700
Minus: Standard deduction ($6,500 + 350)	(6,850)
Taxable income	$ 850

Page Ref.: I:2-24 through I:2-26; Examples I:2-35 and I:2-36
Objective: 3

29) Indicate for each of the following the most favorable filing status for the 2018 tax year.
a. Kenny died on March 2, 2017. Marge, his wife, and Bart, their son, survive. Marge filed a joint return in 2017. Bart, age 18 in 2018, is a full-time college student and continues to live at home with his mother. He works part-time, earning $3,200. What is Marge's filing status in 2018?
b. Alan Spaulding is single and provides over 50% support of his niece Alicia who lives with him all year long. Alan maintains the household and claims Alicia as a dependent. Alicia makes $3,600 at a part-time job. She is a full-time student, age 18. What is Alan's filing status?
c. Lily, who was divorced on July 27, 2018, provides 100% of the support for her parents who live in a nursing home in Kansas and have no income. What is Lily's filing status?
d. Holly was abandoned by her husband Fletcher in September of the current year. She has not seen or communicated with him since then. What is Holly's filing status?
e. Rick, whose wife died in December 2015, filed a joint tax return for 2015. He did not remarry, but has continued to maintain his home in which his two dependent children live. What is Rick's filing status for 2018?
Answer:
a. surviving spouse
b. head of household
c. head of household
d. married filing separately
e. head of household
Page Ref.: I:2-20 through I:2-23
Objective: 3

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30) Gina Lewis, age 16, is claimed as a dependent on her parent's return. She is their only child. She earned $4,300 from a summer job. She also earned interest of $3,750. Her parents' marginal tax rate is 37 percent.

Required:

a. Compute the amount of Gina's tax liability for 2018. The following schedule of tax brackets will be helpful.

Marginal Rate	Portion of TI over ETI Plus	But Not Over ETI Plus
10%		$2,550
24%	$2,550	$9,150
35%	$9,150	$12,500
37%	$12,500	

b. Can Gina's parents take a child tax credit for her?

Answer: Adjusted gross income ($4,300 + $3,750)	$8,050
Less: Standard deduction [greater of $1,050 or ($4,300 + 350)]	(4,650)
Allowable exemption (None-dependent of another)	0
Taxable income	$3,400

Gina's net unearned income:

Unearned income: Interest	$ 3,750
Less: Statutory deduction of $1,050	(1,050)
Less: Standard deduction	(1,050)
Net unearned income	$ 1,650

Gina's earned taxable income (ETI):

Taxable income	$3,400
Less net unearned income	-1,650
Earned taxable income	$1,750

Tax calculation:

Gina's relevant tax bracket- 10% = $1,750 ETI + $2,550 per table = $4,300 for top of 10% bracket

$3,400 taxable income × 10% = $340 tax liability

b. She is under age 17 and their qualifying child so she qualifies for the child credit. The credit will be phased out because the parents' marginal tax rate is 37% so their AGI will be beyond the phaseout range.

Page Ref.: I:2-25; Example I:2-37

Objective: 2 and 3

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31) For each of the following taxpayers, indicate the applicable filing status and the number of children who qualify for the child credit.
a. Jeffrey is a widower, age 71, who receives a pension of $10,000, nontaxable social security benefits of $12,000, and interest of $2,000. He has no dependents.
b. Selma is a single, full-time college student, age 20, who earned $6,800 working part-time. She has $1,700 of interest income and received $1,000 support from her parents.
c. Olivia is married, but her husband left her three years ago and she has not seen or heard from him since. She supports herself and her six-year-old daughter. She paid all the household expenses. Her income consists of salary of $18,500 and interest of $800.
d. Ruben is a single, full-time college student, age 20, who earned $6,800 working part-time. He has $250 of interest income and received $10,000 support from his parents.
e. Cathy is divorced and received $12,000 alimony from her former husband and earned $35,000 working as an administrative assistant. She also received $2,500 of child support for her daughter who lives with her. Cathy filed the appropriate IRS form and gave up the dependency exemption to her former husband.
Answer:

	Filing Status	**Child Credit**
a.	Single	0
b.	Single	0
c.	Head-of-Household	1
d.	Single	0
e.	Head-of-Household	0

Page Ref.: I:2-12 through I:2-24
Objective: 2 and 3

32) Mary Ann pays the costs for her Aunt Hazel to live in a nursing home. Aunt Hazel receives Social Security benefits of $7,000 a year which are turned over to the nursing home. Mary Ann pays the remaining cost of $33,000. Hazel has no other income. Mary Ann visits Hazel twice a week and meets with doctors and nurses regarding Hazel's medical care. What tax issues should Mary Ann consider?
Answer: Can Mary Ann file as head of household? Would Mary Ann be able to claim Hazel as a dependent?
Page Ref.: I:2-22
Objective: 3

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LO4: Business Income and Business Entities

1) The only business entity that pays federal income taxes is the C corporation.
Answer: TRUE
Explanation: S corporations and partnerships are both flow-through entities. Sole proprietors report the sole proprietorship income directly on their individual income tax return.
Page Ref.: I:2-27 through I:2-29
Objective: 4

2) The annual tax reporting form filed with the IRS by C corporations is the Schedule C.
Answer: FALSE
Explanation: C corporations file Form 1120. Sole proprietors report business income on Schedule C, which is included with individual's Form 1040.
Page Ref.: I:2-29
Objective: 4

3) A corporation has revenue of $350,000 and deductible business expenses of $240,000. What is the federal income tax, before credits?
A) $26,400
B) $22,000
C) $23,100
D) $38,500
Answer: C
Explanation: Taxable income is $110,000 ($350,000 - $240,000). The tax liability is $23,100 [.21 × 110,000] .
Page Ref.: I:2-29
Objective: 4

4) Ray is starting a new business and trying to decide between a C corporation, S corporation, and partnership. Which of the following statements regarding his decision is correct?
A) An S corporation owner must pay income taxes only on the salary received.
B) A partner in a partnership is taxed on his or her share of partnership income.
C) A shareholder in a C corporation is taxed on his or her share of corporate income.
D) S corporations pay taxes on their current year income.
Answer: B
Explanation: The partnership form is a flow-through entity.
Page Ref.: I:2-27 through I:2-29
Objective: 4

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5) Artco Inc. is a C corporation. This year it earned $50,000 of taxable income and paid a $10,000 distribution (dividend) to Lily, its sole shareholder. Lily has a marginal tax rate of 24%. Due to the corporation's results and the distribution paid, the IRS will receive total taxes of
A) $12,000.
B) $12,900.
C) $13,500.
D) $10,500.
Answer: A
Explanation:

Corporate tax	$50,000 × 21% corporate tax rate on $50,000	$10,500
Lily's tax on dividend	$10,000 × 15% dividend rate	1,500
Total tax		$12,000

Page Ref.: I:2-27 and I:2-28; Example I:2-40
Objective: 4

6) Silver Inc. is an S corporation. This year it earned $60,000 of taxable income and paid a $10,000 distribution to Daisy, its sole shareholder. Daisy has a marginal tax rate of 24%. Due to the corporation's results and the distribution paid, the IRS will receive total taxes of
A) $27,000.
B) $14,400.
C) $14,100.
D) $9,000.
Answer: B
Explanation:

Corporate tax		$ 0
Daisy's tax on flow-through income	$60,000 × 24% marginal tax rate	14,400
Daisy's tax on distribution		0
Total tax		$14,400

Page Ref.: I:2-27 and I:2-28; Example I:2-40
Objective: 4

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7) Paige is starting Paige's Poodle Parlor and is considering alternative organizational forms. She anticipates the business will earn $100,000 from operating before compensating her for her services and before charitable contributions. Page, who is single, has $6,000 of income from other sources and other itemized deductions of $12,000. Her compensation for services will be $50,000. Charitable contributions to be made by the business are expected to be $5,000. Other distributions (dividends) to her from the business are expected to be $14,000.

Required: Compare her 2018 income tax assuming she operates the business as a proprietorship, an S corporation, and a C corporation. Ignore payroll and other taxes.
Answer:

	Proprietorship	*S Corporation*	*C Corporation*
Business income:			
Operating income	$100,000	$100,000	$100,000
Compensation paid to Paige		(50,000)	(50,000)
Charitable contributions			(5,000)
Net business income	$100,000	$ 50,000	$ 45,000
Corporate income tax			$ 9,450
Paige's income:			
Business income (above)	$100,000	$ 50,000	
Compensation (above)		50,000	$ 50,000
Dividends			14,000
Other income	6,000	6,000	6,000
Adjusted gross income	$106,000	$106,000	$ 70,000
Charitable contributions	5,000	5,000	
Other itemized deductions	12,000	12,000	12,000
Taxable income	$ 89,000	$ 89,000	$ 58,000
Individual income tax	$ 15,650*	$ 15,650*	$ 7,826**
Total tax	$ 15,650	$ 15,650	$ 14,576

*$14,089.50 + [.24 × ($89,000 -82,500) rounded
**Tax on dividends: $14,000 × .15 = $2,100 plus
Tax on taxable income of $58,000 - 14,000 or $44,000: $4,453.50 + [.22 × ($44,000 - 38,700)] = $5,620 (rounded). The total is $7,720.
Page Ref.: I:2-27 and I:2-28; Example I:2-40
Objective: 4

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LO5: Treatment of Capital Gains and Losses

1) A $10,000 gain earned on stock held 13 months is taxed in a more favorable manner than a $10,000 gain earned on stock held 11 months.
Answer: TRUE
Explanation: Lower tax rates apply to long-term capital gains.
Page Ref.: I:2-30
Objective: 5

2) A building used in a business is sold after five years of use for a gain. The gain will be treated as a long-term capital gain.
Answer: FALSE
Explanation: Depreciable business property is excluded from the definition of a capital asset.
Page Ref.: I:2-30
Objective: 5

3) If an individual with a taxable income of $15,000 has a long-term capital gain, it is taxed at
A) 0%.
B) 20%.
C) 10%.
D) 15%.
Answer: A
Explanation: Taxpayers with taxable income of $38,600 or less will have a 0% tax rate on long-term capital gains.
Page Ref.: I:2-30
Objective: 5

4) If a single taxpayer with a marginal tax rate of 37% has a long-term capital gain, it is taxed at
A) 0%.
B) 20%.
C) 10%.
D) 15%.
Answer: B
Explanation: Single taxpayers with a marginal tax rate of 37% will have a 20% tax rate on long-term capital gains. The 37% marginal tax rate starts at $500,000 for a single individual, and the 20% long-term capital gain rate starts at taxable income of $425,800 for a single taxpayer.
Page Ref.: I:2-30
Objective: 5

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5) If a single taxpayer with a marginal tax rate of 24% has a long-term capital gain, it is taxed at
A) 0%.
B) 20%.
C) 25%.
D) 15%.
Answer: D
Explanation: Single taxpayers with taxable income exceeding $38,600 but less than $425,800 will have a 15% tax rate on long-term capital gains. The 24% marginal tax rate for single taxpayers ranges from $82,500 to $157,500.
Page Ref.: I:2-30
Objective: 5

6) Steve and Jennifer are in the 32% tax bracket for ordinary income and the 15% bracket for capital gains. They have owned several blocks of stock for many years. They are considering the sale of two blocks of stock. The sale of one would produce a gain of $12,000 while the sale of the other would produce a loss of $18,000. For purposes of this problem, ignore itemized deductions, phase-outs and additional investment taxes. They have no other gains and losses this year.
a. How much tax will they save if they sell the block of stock that produces a loss?
b. How much additional tax will they pay if they sell the block of stock that produces a gain?
c. What will be the impact on their taxes if they sell both blocks of stock?
Answer:
a. $990. A net capital loss is limited to $3,000 per year × .32 = $960. They can carryover the remaining $15,000 loss to next year.
b. $12,000 × .15 (maximum rate on long-term capital gains) = $1,800.
c. $12,000 gain - $18,000 loss = Net capital loss of $6,000 of which $3,000 is currently deductible to save taxes of $3,000 × .32 = $960. They should sell both so that they totally escape taxation of the gain this year. They can carryover the remaining $3,000 loss to next year.
Page Ref.: I:2-30
Objective: 5

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LO6: Tax Planning Considerations

1) Mr. and Mrs. Kusra are in the top tax bracket. They have just had a baby. The Kusras plan to gift a corporate bond they currently own to the baby. The bond pays $2,100 of interest income per year. The Kusra family overall will save taxes if the bond is transferred to the child.
Answer: TRUE
Explanation: Kiddie tax ramifications do not apply until the child has earned more than $2,100 of investment income.
Page Ref.: I:2-31 and I:2-32
Objective: 6

2) Ivan Trent, age five, receive $2,900 of dividends per year from a mutual fund he owns; it is his only source of taxable income. Ivan's parents plan to gift a corporate bond they currently own to him. The bond pays $4,100 of interest income per year. Ivan's parents are in the 37% tax bracket. The individual income tax rate schedule that generally applies to a single taxpayer indicates a 10% tax rate until taxable income of $9,525. Ivan's family will save tax at the rate of 27% (37% - 10% tax rates) on the bond interest income if the parents transfer the bond to Ivan.
Answer: FALSE
Explanation: The child is subject to kiddie tax because he already receives investment income in excess of the $2,100 threshold. The tax on the interest income from the bond owned by the child will increase to higher tax rates above taxable income of $2,550 under the tax rates effective under kiddie tax.
Page Ref.: I:2-31 and I:2-32
Objective: 6

3) Generally, when a married couple files a joint return, each spouse is liable for one-half of the entire tax and any penalties incurred.
Answer: FALSE
Explanation: Joint liability applies for the full tax.
Page Ref.: I:2-32
Objective: 6

4) A taxpayer is able to change his filing status from married filing jointly to married filing separately by filing an amended return.
Answer: FALSE
Explanation: Taxpayers are not able to change their status from filing a joint return to separate returns, although they can change their status from separate returns to a joint return by filing an amended return.
Page Ref.: I:2-33
Objective: 6

5) In order to shift the taxation of dividend income from a parent to a child
A) the parent must direct the corporation to pay the dividend to the child.
B) the parent must transfer ownership of the stock to the child.
C) the parent can deposit the dividend in the child's bank account.
D) all of the above will result in shifting the taxation to the child.
Answer: B
Explanation: Actual ownership of the asset must transfer to the child.
Page Ref.: I:2-32; Examples I:2-43 and I:2-44
Objective: 6

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6) Married couples will normally file jointly. Identify a situation where a married couple may prefer to file separately.
A) The spouse with lower income has substantial medical expenses.
B) A couple is separated and contemplating divorce.
C) One spouse can be held responsible for the entire tax liability.
D) All of the above.
Answer: D
Explanation: Responses A, B and C all provide situations where married filing separately may be preferential.
Page Ref.: I:2-32
Objective: 6

7) A taxpayer can receive innocent spouse relief if
A) the understated tax is attributable to erroneous items of the other spouse.
B) the innocent spouse did not know and had no reason to know that there was an understatement of tax.
C) under the circumstances, it would be inequitable to hold the innocent spouse liable for the understated tax.
D) All of the above conditions apply.
Answer: D
Explanation: All of the items are required for innocent spouse relief.
Page Ref.: I:2-32
Objective: 6

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8) Kelsey is a cash-basis, calendar-year taxpayer. Her salary is $60,000, and she is single. She plans to purchase a residence in 2019. She anticipates her property taxes and interest will total $11,000 in 2019. Each year, Kelsey contributes approximately $1,500 to charity. Her other itemized deductions total $2,000. For purposes of this problem, assume the 2018 standard deduction amount remains in effect for 2019.

a. What will be her deductions from AGI in 2018 and 2019 if she contributes $1,500 to charity in each year?

b. What will be her deductions from AGI in 2018 and 2019 if she contributes $3,000 to charity in 2018 but makes no contribution in 2019?

c. What will be her deductions from AGI in 2018 and 2019 if she makes no contribution in 2018 but contributes $3,000 to charity in 2019?

d. Why does option C yield the largest deductions over time?

Answer:

		2018	**2019**
a.	Potential itemized deduction	$ 3,500	$14,500
	Standard deduction	12,000	12,000
	Deduction from AGI (larger of above)	$12,000	$ 14,500
	Deductions across two years		$ 26,500
b.	Potential itemized deduction	$ 5,000	$13,000
	Standard deduction	12,000	13,000
	Deduction from AGI (larger of above)	$12,000	$ 13,000
	Deductions across two years		$ 25,000
c.	Potential itemized deduction	$ 2,000	$16,000
	Standard deduction	12,000	12,000
	Deduction from AGI (larger of above)	$12,000	$ 16,000
	Deductions across two years		$ 28,000

d. The contributions have no tax benefit in 2018 because the standard deduction is taken and charitable contributions are itemized deductions.

Page Ref.: I:2-31 and I:2-32
Objective: 6

9) Discuss reasons why a married couple may choose not to file a joint return.

Answer:

1. One spouse incurs most of medical expenses and itemized deductions can be maximized.
2. They may not want joint tax liability.
3. Casualty losses may be deductible on a separate return but not on a joint return because of the 10% floor.

Page Ref.: I:2-32 and I:2-33
Objective: 6

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10) Discuss why Congress passed the innocent spouse provision and detail the requirements to be met in order to qualify as an innocent spouse and be relieved of liability for tax on unreported income.
Answer: The provision was passed because each spouse is liable for the entire tax on a joint return as well as penalties imposed. This would not be fair if one spouse concealed information regarding income or deductions from the other spouse.

An innocent spouse is relieved of liability when
1. The amount is attributable to grossly erroneous items of the other spouse.
2. The innocent spouse did not know of and had no reason to know that there was such an understatement of tax.
3. To hold the innocent spouse liable for the understatement would be inequitable.
4. The innocent spouse elects relief within two years after the IRS begins collection activities.
Page Ref.: I:2-32
Objective: 6

11) Oscar and Diane separated in June of this year although they continue to live in the same town. They have twin sons, Blake and Cliff, who remain in the family home with Diane. Oscar's income this year was $45,000 while Diane worked only part-time and made $15,000. Oscar also gambles heavily but told Diane that he had no winnings this year. What tax issues should they consider?
Answer: Oscar and Diane have several choices for filing status. Since they are still married on December 31, the last day of the tax year, they could file jointly. That will probably result in the lowest overall tax liability. However, they should consider joint and several liabilities, especially if Diane fears that Oscar may be hiding income. If Diane is maintaining the home in which at least one dependent child lives, she may be able to file as head of household. Of course, they could file separately which would result in the highest overall tax liability.
Page Ref.: I:2-32 and I:2-33
Objective: 6

12) Alexis and Terry have been married five years and file joint tax returns. Alexis began embezzling funds from her employer during the third year of their marriage. Last year, Alexis suddenly left the country and Terry does not know where she is. In the current year, Terry learned that the IRS had assessed him $27,000 in unpaid taxes due to Alexis's embezzlement. What tax issue(s) are present in Terry's situation? What questions would you ask Terry to determine his appropriate response to the IRS?
Answer: Is Terry eligible for innocent spouse relief? Did Terry benefit financially from Alexis's embezzlement? Did Terry have reason to know of the embezzlement?
Page Ref.: I:2-32 and I:2-33
Objective: 6

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LO7: Compliance and Procedural Considerations

1) The requirement to file a tax return is based on the individual's adjusted gross income.
Answer: FALSE
Explanation: The requirement to file is based on the individual's gross income.
Page Ref.: I:2-33
Objective: 7

2) Tax returns from individual and C corporate taxpayers are due on the 15th day of the third month following the close of the tax year.
Answer: FALSE
Explanation: Individual returns and C corporation returns are both due on the 15th day of the fourth month following the close of the tax year.
Page Ref.: I:2-34
Objective: 7

3) Tax returns from individual taxpayers and partnerships are due on the 15th day of the fourth month following the close of the tax year.
Answer: FALSE
Explanation: Individual returns are due on the 15th day of the fourth month following the close of the tax year, but partnership tax returns are due the 15th day of the third month.
Page Ref.: I:2-34
Objective: 7

4) Assuming a calendar tax year and the conventional 15th of the month due date, all of the following business entities must file their 2018 tax returns by the March 15, 2019 except
A) the C corporation.
B) the S corporation.
C) the partnership.
D) All of the above entities must file their 2018 tax returns by March 15, 2019.
Answer: A
Explanation: A calendar-year C corporation 2018 tax return deadline is April 15, 2019 (note—due to a holiday, the actual due date is April 17).
Page Ref.: I:2-34
Objective: 7

5) Form 4868, a six-month extension of time to file, allows a taxpayer to
A) avoid interest on underpayment of taxes due.
B) extend the filing date of the return as well as payment of the tax due.
C) extend the filing date of the return but the estimated amount of tax due must still be paid by the original due date of the return.
D) extend the filing date only at the discretion of the IRS.
Answer: C
Explanation: An extension to file a return is not an extension to pay any tax that is owed.
Page Ref.: I:2-34
Objective: 7

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6) Lester, a widower qualifying as a surviving spouse, has $209,000 of salary, five personal and dependency exemptions and itemizes deductions. Lester must use which form to report his taxable income?
A) Form 1040ES
B) Form 1040EZ
C) Form 1040A
D) Form 1040
Answer: D
Explanation: Itemized deductions may be claimed only on Form 1040.
Page Ref.: I:2-35
Objective: 7

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