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Chapter I:1

An Introduction to Taxation

Discussion Questions

I:1-1 The Supreme Court held the income tax to be unconstitutional in 1895 because the income tax was considered to be a direct tax. At that time, the U.S. Constitution required that an income tax be apportioned among the states in proportion to their populations. This type of tax system would be extremely difficult to administer because different rates of tax would apply to individual taxpayers depending on their states of residence. p. I:1-2.

I:1-2 The pay-as-you-go withholding was needed in 1943 to avoid significant tax collection problems as the tax base broadened from 6% of the population in 1939 to 74% in 1945. Pay-as-you-go permitted the federal government to deduct taxes directly out of an employee's wages. p. I:1-3.

I:1-3 Under a progressive tax rate structure, the tax rate increases as the taxpayer's income increases. Currently, for 2024, tax rates of 10%, 12%, 22%, 24%, 32%, 35% or 37% apply depending upon the taxpayer's filing status and taxable income levels. Under a proportional tax rate or "flat tax" structure, the same tax rate applies to all taxpayers regardless of their income levels. Under a regressive tax rate structure, the tax rate decreases with an increase in income level. The concept of vertical equity holds that taxpayers with higher income levels should pay a higher proportion of tax and that the tax should be borne by those who have the "ability to pay." Thus, Congressman Patrick's opposition to the flat tax is philosophically correct; under a flat tax system, all taxpayers pay taxes at the same rate, regardless of the ability to pay. pp. I:1-4 and I:1-5.

I:1-4 It is possible for the government to raise taxes without raising tax rates. Because there are two components in computing a taxpayer's tax, the tax base and the tax rate, taxes can be raised by increasing either the rate or the base. Thus, even though the Governor proclaimed that tax rates have remained at the same level, adjustments to the tax base, such as the elimination of deductions, result in tax increases which can be as much, or more, as increases in tax rates. p. I:1-4.

I:1-5 The marginal tax rate is of greater significance in measuring the tax effect for Carmen's decision. The marginal tax rate is the percentage that is applied to an incremental amount of taxable income that is added to or subtracted from the tax base. Through the marginal tax rate, the taxpayer may measure the tax effect of the charitable contribution to her church. If her marginal tax rate is 24%, she will save 24¢ for each $1 contributed to her church. The average tax rate is simply the total tax liability divided by taxable income. pp. I:1-5 and I:1-6.

I:1-6 Gift and estate taxes are levied when a transfer of wealth (property) takes place and are both part of the unified transfer tax system. The tax base for computing the gift tax is the fair market value of all gifts made in the current year minus an annual donee exclusion of $18,000 (2024) per donee, minus a marital deduction for gifts to spouse and a charitable contributions

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deduction if applicable, plus the value of all taxable gifts in prior years. The tax base for the estate tax is the decedent's gross estate, minus deductions for expenses, and a marital or charitable deduction if applicable, plus taxable gifts made after 1976. pp. I:1-7 through I:1-10.

I:1-7 a. Cathy, the donor, is primarily liable for the gift tax on the two gifts. The children are contingently liable for payment of the gift tax in the event the donor fails to pay.

b. Before considering the unified tax credit equivalent of $13.61 million for 2024, a gift tax results on the two gifts for the current year 2024 computed as follows:

Total gifts	$100,000
Minus: Annual gift tax exclusion ($18,000 x 2 donees)	(36,000)
Gift tax base	$ 64,000

Since Cathy has never made gifts in prior years, no gift tax will be due because of the substantial unified tax credit that is available. pp. I:1-8 and I:1-9.

I:1-8 Carlos would report a taxable gain of $2,000 ($27,000 - $25,000). His tax basis in the stock that he inherited is the fair market value on the date of his father's death. pp. I:1-9 and I:1-10.

I:1-9 a. Most estates are **not** subject to the federal estate tax because of generous credit and deduction provisions, such as the unified tax credit and the unlimited marital deduction. The unified tax credit equivalent for 2024 is $13.61 million. This means that, at a minimum, for decedents dying in 2024, no estate of $13.61 million or less will be subject to the federal estate tax.

b. This is a controversial question that has proponents on both sides of the issue. Those that believe the estate tax should be reduced or eliminated basically argue that the estate tax is a double tax, that is, the property of the decedent has already been subject to income taxation during his or her lifetime and should not be subjected to further taxation at death. On the other hand, proponents of retaining or increasing the estate tax believe in the ability to pay principle. p. I:1-10.

I:1-10 a. Progressive.
b. Progressive.
c. Proportional.
d. Proportional.
e. Proportional. (However, state and local sales taxes are considered regressive when measured against income).
pp. I:1-4 and I:1-5 and I:1-12.

I:1-11 Decrease. When Carolyn operates her business as a sole proprietor, she is considered to be self-employed. A self-employment tax is imposed at the rate of 15.3% for 2024 (12.4% OASDI + 2.9% Medicare) on all of her business income with a ceiling on the non-hospital insurance (OASDI) portion of the tax base of $168,600 in 2024. Carolyn is also entitled to an income tax deduction equal to 50% of the self-employment tax payments if she is self-employed. If she works as an employee, however, the OASDI and Medicare taxes are imposed at the employee level at a rate of 7.65% for 2024. The OASDI is imposed on earned income up to a maximum of $168,600 in 2024 while Medicare taxes have no ceiling. Her employer would have to match Carolyn's OASDI and Medicare taxes. Thus, Social Security taxes are levied at the

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same rate of 15.3% (7.65% on the employee and 7.65% on the employer). If the corporation does not pay Carolyn a salary equal to its earnings, the Social Security taxes will be slightly less than under the sole proprietorship. The hospital insurance portion of the FICA premium continues to apply with no ceiling amount for employees, employers, and self-employed individuals. The rate is 2.9% for self-employed individuals and 1.45% each for employees and employers. p. I:1-11.

I:1-12 a. Property taxes are primarily used by local governments and include both real property taxes (real estate) and personal property taxes (tangible and intangible property).

b. Excise taxes are primarily used by the federal government and are imposed on items such as alcohol, tobacco, telephone usage, and many other goods. While not as extensive as the federal government, many state and local governments impose similar types of taxes.

c. Sales taxes are primarily used by state governments and constitute a major revenue source for many states. Local governments are increasingly using sales taxes as well as states. The local governments frequently tack-on 1¢ or 2¢ to the existing state sales tax rather than imposing a separate sales tax.

d. Income taxes are the primary domain of the federal government and constitutes its major source of revenue. However, many state and local governments now use the income tax in their revenue structures.

e. Employment taxes are primarily used by the federal government. Social security (FICA) taxes are a major source of federal revenue. Unemployment taxes are used by states as a compliment to the federal unemployment compensation tax. pp. I:1-10 and I:1-11.

I:1-13 a. The five characteristics of a "good" tax are equity, certainty, convenience, economy, and simplicity. Equity refers to the fairness of the tax to the taxpayers. A certain tax is one that ensures a stable source of government revenue and provides taxpayers with some degree of certainty concerning the amount of their annual tax liability. Convenience refers to the case of assessment, collectability, and administration for the government and reasonable compliance requirements for taxpayers. An economical tax requires minimal compliance costs for taxpayers and minimal administration costs for the government. Simplicity means the tax system is simple to understand and to comply.

b. 1. The federal income tax meets the first four criteria reasonably well, even though many critics would suggest otherwise. The tax is reasonably fair in that the high-income taxpayers pay the most tax, the low-income taxpayers the least tax. While tax laws are constantly changing, most taxpayers have a pretty good idea of what their taxes are going to be for the tax year and the federal income tax does provide the government with a stable source of revenue. The tax is convenient to pay although compliance requirements for taxpayers have risen steadily over the years. The tax is economical for the government to collect; however, the cost of compliance for taxpayers is much too high as approximately 56% of all taxpayers pay a tax preparer to prepare their tax returns. However, virtually no one would suggest that the federal income tax law is simple. In fact, complexity is one of the law's major flaws.

2. The state sales tax meets the criteria of certainty, convenience, economy and simplicity quite well. However, the sales tax is criticized as not being equitable as it tends to fall more heavily on lower and middle-income taxpayers.

3. Property taxes do not fare well according to the characteristics of a "good" tax. From equity standpoint, the property tax is imposed on property owners without regard to their income situation. Thus, a farmer may have substantial property but little income to pay the

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property tax. Property taxes are certain but clearly not convenient in the sense that they are normally assessed in a lump-sum amount once a year. Property taxes do not meet the economy criteria. Property taxes are rather simple although differences in judgments as to valuation of property are a problem. pp. I:1-12 through I:1-14.

I:1-14 a. Horizontal equity refers to the concept that similarly situated taxpayers should pay approximately the same amount of tax. Vertical equity, on the other hand, refers to the concept that higher income taxpayers should not only pay a higher amount of tax but should pay a higher percentage of tax. Vertical equity is based on the notion that taxpayers who have the "ability to pay" (e.g., higher income taxpayers) should pay more tax than lower income taxpayers.

b. Fairness is an elusive term. Because of widely divergent opinions as to what constitutes fairness, it logically follows that there are also many different and divergent opinions as to what constitutes a "fair" tax structure. p. I:1-13.

I:1-15 Secondary objectives include the following:

a. Economic objectives such as stimulating private investment, reducing unemployment, and mitigating the effects of inflation.
b. Encouraging certain activities such as research and development and small business investment.
c. Social and public policy objectives, (e.g. encouraging charitable contributions and discouraging illegal bribes). pp. I:1-14 and I:1-15.

I:1-16 Probably not. It would be difficult to achieve a simplified tax system and also provide incentives to certain industries as well as achieve social objectives. To achieve a simplified tax system would require the elimination of special purpose provisions, such as with the several consumption tax proposals being forwarded. But consumption taxes generally are considered unfair as they fall disproportionately on the low and middle class. pp. I:1-14 through I:1-16.

I:l-17 Taxpaying entities generally are required to pay income taxes on their taxable income. The major taxpaying entities are individuals and C corporations. Flow-through entities generally do not directly pay income taxes on their taxable income but merely pass the income on to a taxpaying entity. The major flow-through entities are sole proprietorships, partnerships, S corporations, limited liability companies (LLC), limited liability partnerships (LLP), and certain trusts. Some entities do not neatly fall within each category and are actually hybrid entities. S corporations, for example, are subject to income taxes in certain situations, such as taxes on built-in gains, the LIFO recapture tax, etc. Not many S corporations incur these taxes. pp. I:1-16 through I:1-24.

I:1-18 Sally and Tom's taxable income for 2024 would be $110,800, computed as follows:

AGI	$ 140,000
Larger of itemized deductions ($22,000) or standard deduction ($29,200)	(29,200)
Taxable income	$ 110,800

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If Sally and Tom had itemized deductions of $32,000 rather than of $22,000, their taxable income would be $108,000, computed as follows:

AGI	$ 140,000
Larger of itemized deductions ($32,000) or standard deduction ($29,200)	(32,000)
Taxable income	$ 108,000

As can be seen previously, the standard deduction of $29,200 is larger than $22,000 of their itemized deductions, so they obviously would claim the standard deduction. Alternatively, if the itemized deductions were $32,000, their taxable income would be 108,000 ($140,000 - $32,000) as the itemized deductions exceed the standard deduction of $29,200. Taxpayers are allowed to deduct the greater of itemized deductions or the standard deduction. pp. I:1-6, I:1-7, and I:1-17.

I:1-19 To properly respond to Bruin, tax calculations for both Bruin Corporation and John Bean must be made for the year.

$400,000 dividend. If the $400,000 is distributed to John as a dividend, Bruin Corporation would get no deduction for the dividend and would have corporate taxes of $105,000 ($500,000 x 0.21) based on taxable income of $500,000. John would then pay a maximum rate of 20% on the dividend because his taxable income is greater than $518,900 given the tax bracket he is in the 37% bracket starts at taxable income over $609,350 for single taxpayers, so the income taxes due by John on the $400,000 dividend would be $80,000. Thus, the total income taxes would be $185,000 ($105,000 + $80,000).

$400,000 salary. If the $400,000 is distributed to John as a salary, Bruin Corporation would be allowed a deduction and the corporation's taxable income now would be $100,000. The corporate tax on $100,000 is $21,000. John would be required to pay income taxes on the $400,000 at 37%, so the tax would be $148,000. The total income taxes for the year would be $169,000.

As can be seen from the analysis above, the $400,000 salary would result in smaller taxes. This results even though John is in the top 37% tax bracket. The tax savings would be even higher if John were in a lower tax bracket. (Note that this solution ignores the incremental 3.8% tax on net investment income for high income taxpayers, which is discussed in later chapters). pp. I:1-19 and I:1-20.

I:1-20 The term "double taxation" refers to the taxing of the same income twice. This type of taxation typically results from a C corporation paying tax on its taxable income and shareholders paying income tax on any dividends received from the C corporation. The impact of double taxation of C corporations has been substantially reduced by the fact that dividends generally are taxed at a 15% rate with a maximum rate of 20%. An example of double taxation can be seen in Example I:1-15 of the textbook. pp. I:1-19 and I:1-20.

I:1-21 Limited liability companies (LLCs) generally are taxed as partnerships. Therefore, the LLC is not subject to income tax on its taxable income but such income is allocated to the members (owners) of the LLC. Thus, only a single-level of taxation is imposed. The same

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allocation rules that pertain to partnerships also apply to LLCs. Another principle feature of LLCs is limited liability for owners (members) of the LLC. pp. I:1-22 and I:1-23.

I:1-22 To prevent double taxation, the tax law allows partners to increase their basis in the partnership for any income that is allocated to the partner. Since partnership distributions are not subject to taxation if such distributions are less than the partner's basis, double taxation is prevented. Similarly, to prevent double deductions, the tax law requires partners to decrease their basis for any loss or deduction that is allocated to the partner. pp. I:1-21 and I:1-22.

I:1-23 Schedule K-1 is an integral part of both the annual partnership tax return and the S corporation tax return. Partnerships and S corporations use the same allocation system. The K-1 reports a partner's allocable share of partnership ordinary income and separately-stated items, such as dividends, long-term capital gains, etc. A K-1 is prepared for each partner in the partnership and is filed with Form 1065. So, if a partnership has ten partners, there will be ten K-1s that allocate the total partnership income to each partner. A copy of each partner's K-1 is provided to the partners so that they can report the information on their own tax returns. pp. I:1-21 and I:1-22.

I:1-24 Quint's taxable income for 2024 is computed as follows:

Allocable share of PDQ Partnership income ($150,000 x .3333)	$50,000
Other income	15,000
Adjusted gross income (AGI)	$ 65,000
Standard deduction	$(14,600)
Taxable income	$50,450

The $30,000 distribution from the partnership is considered a return of capital and is not taxable to Quint. Since he reports his allocable share of partnership income, if the distribution were taxed again, the result would be double taxation. If the partnership is eligible for the 20% qualified business income (QBI) deduction, Quint would also be allowed a deduction of $10,000 ($50,000 x 0.20) for his share of partnership income. pp. I:1-17 and I:1-21.

I:1-25 Because of the vast volume of tax law sources, it is nearly impossible for any person to have recall knowledge of the entire tax law. Thus, the ability to understand what the relevant sources of tax law are, their relative weight (importance), and where to find the sources are vital to a person working in the tax area. p. I:1-24.

I:1-26 Even though the Code is the highest authority of tax law sources, the Code contains general language and does not address the many specific situations and transactions that occur. To resolve tax questions concerning specific situations, administrative rulings and court decisions are an integral part of the income tax law. p. I:1-24.

I:1-27 a. Ways and Means Committee (House of Representatives), Senate Finance Committee (U.S. Senate) and the Joint Conference Committee.

b. Committee reports are helpful for two major purposes: (1) to explain the new law before the Treasury Department drafts regulations on the tax law changes, and (2) to explain the intent of Congress for passing the new law. pp. I:1-24 through I:1-26.

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I:1-28 The National Office of the IRS issues revenue rulings to provide guidance to taxpayers on specific factual situations, processes ruling requests from taxpayers (private letter rulings), and prepares Revenue Procedures that assist taxpayers with compliance matters. Of course, the National Office also provides administrative and human resources functions at the top level of the organization. p. I:1-26.

I:1-29 Individuals most likely to be audited include those that may be involved in any of the following situations:

- Individuals who are sole proprietors and incur significant expenses in connection with the trade or business.
- Itemized deductions in excess of an average amount for the person's income level.
- Filing of a refund claim by a taxpayer who has been previously audited and the audit resulted in a substantial tax deficiency.
- Individuals who are self-employed with substantial business income or income from a profession such as a medical doctor. p. I:1-27.

I:1-30 a. Rarely will the IRS review each line of Anya's return. Audits of individual taxpayers generally focus on selected items on the return. Note: In prior years, the IRS had a Taxpayer Compliance Measurement Program (TCMP) where a small number of taxpayers were selected by a random sample and their returns were audited on a line-by-line basis. These audits were primarily for statistical purposes. Currently, this program has been abandoned. However, the IRS now uses the National Research Program (NRP) to select returns for audit. The NRP will update data compiled in the old TCMP audits and develop new statistical models for identifying returns most likely to contain errors.

b. Generally not all items on a return will be audited. All tax returns are initially checked for mathematical accuracy and items that may be considered clearly erroneous. If differences are noted the IRS sends the taxpayer a bill for the corrected amount. Upon an audit of Anya's return, the IRS generally only examines selected items on the return. These items are those that the IRS believes there is a possibility of error. p. I:1-27.

I:1-31 a. The term "hazards of litigation" refers to the probability of winning or losing a case if it goes to court.

b. Because of the possibility that a case may be lost and the cost of litigation, both the IRS and taxpayers frequently settle a case to avoid such possibilities. The IRS may also decide to settle a case because it does not want to establish an unfavorable precedent of cases in a specific area. A taxpayer may settle a case to avoid substantial legal and professional fees. p. I:1-29.

I:1-32 No, just because the taxpayer has filed a return and received a refund, the IRS may still audit a taxpayer. Tax returns that are selected for audit generally are audited a year or two after the return is received by the IRS. p. I:1-28.

I:1-33 a. The statute of limitations remains open indefinitely if a fraudulent return is filed or if no return is filed at all.

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b. The general rule for the disallowance of tax deduction items is that an assessment may be made against the taxpayer within three years from the later of the date the tax return was filed or its due date.

c. A six-year statute of limitations applies if the taxpayer omits an item of gross income that is in excess of 25 percent of the gross income that is reported on the return. p. I:1-28.

I:1-34 The best possible defensibly correct solution is one that is advantageous to the client but is based upon substantial authoritative support (e.g., favorable court cases) even though the position may be challenged upon audit by the IRS. p. I:1-30.

I:1-35 The four principal areas of activity for the profession of tax practice are: tax compliance and procedure, tax research, tax planning and financial planning. Tax compliance and procedure essentially consists of tax return preparation and assisting the taxpayer in dealing with the IRS. Tax research is the process of developing the most defensibly correct solution to a tax problem. Tax planning involves the process of reducing taxes so as to maximize a taxpayer's after-tax return. Financial planning, while not exclusively related to tax, is an area for tax professionals to assist clients with planning for their entire financial affairs. pp. I:1-29 through I:1-31.

I:1-36 a. Because income taxes may exceed 50% of a taxpayer's income (including federal, state, and local income taxes and Social Security taxes), taxes are an extremely important part of the financial planning process. Any financial plan that does not carefully consider taxes is a flawed plan.

b. Because tax professionals see their clients at least once a year at a minimum (preparation of their income tax returns) and are familiar with the client's financial information, this represents a perfect opportunity to perform financial planning. p. I:1-31.

I:1-37 No, the principal goal of tax planning is to maximize a taxpayer's after-tax cash flow, not just the minimization of taxes due. For example, if a taxable investment generates a better return after taxes are paid than a nontaxable investment, the taxable investment is superior even though taxes must be paid. p. I:1-30.

I:1-38 Tax planning involves the evaluation of alternative courses of action. The evaluation of alternative courses of action can be very time-consuming because of the numerous and complex tax calculations necessary to arrive at an optimal solution. Using tax software has become an essential tool in this process because of the speed and accuracy in which tax calculations can be made as well as data analytic methods to analyze large amounts of tax data. pp. I:1-30 and I:1-31. Tax planning and complex tax calculations, as well as tax research are increasingly performed, or at least assisted, by artificial intelligence (AI).

Problems

I:1-39 a.

Income:		
Salary		$100,000
Business income		25,000

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Interest income		10,000
		$135,000
Deductions:		
Business expenses	$9,500	
Itemized deductions	20,000	29,500
Taxable Income		$105,500
Tax		$18,363

Note: Tax-exempt bond interest is not taxable and itemized deductions are greater than the standard deduction amount.

b. Marginal rate = 24% (From tax rate schedule)
Average rate = 17.41% ($18,363/$105,500)
Effective rate = 14.41% ($18,363/($135,000 + $5,000 - $9,500))

c. From a tax planning point of view, the marginal rate is the most important rate because it measures the tax saving from each additional $1 of deduction (or additional tax from each additional $1 of taxable income). pp. I:1-4 through I:1-7 and I:1-17 and I:1-18.

I:1-40. The income tax payable, average tax rate, and marginal tax rate for each amount for 2024 for married couples filing joint income tax returns is as follows:

a. $2,320 + .12($30,000 - $23,200) = $3,136
Average tax rate: $3,136/$30,000. = 10.45%
Marginal tax rate: 12%

b. $10,852 + .22($100,000 - $94,300) = $12,106
Average tax rate: $12,106/$100,000. = 12.11%
Marginal tax rate: 22%

c. $78,221 + .32($425,000 - $383,900) = $91,373
Average tax rate: $91,373/$425,000. = 21.50%
Marginal tax rate: 32%

d. $196,669.50 + .37($800,000 - $731,200) = $222,125.50
Average tax rate: $222,125.50/$800,000 = 27.77%
Marginal tax rate: 37%

Note: This problem clearly demonstrates the progressive nature of the federal income tax. The average tax rate rises from 10.45% to 27.77% in this problem.

I:1-41 a. Their marginal tax rate with $500,000 of taxable income is 35%. However, with an additional $40,000 of deductions, their taxable income drops to $460,000, which would reduce their marginal tax rate to 32% (for 2024, the 35% rate begins when taxable income exceeds $487,450).

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b. Their tax savings using the 2024 Tax Rate Schedules and married filing jointly would be computed as follows:

Tax on $500,000	$ 115,750
Tax on $460,000	(102,573)
Tax savings	$ 13,177

pp. I:1-4 through I:1-7.

I:1-42 Betty's taxable gift for the current year (2024) is $82,000 computed as follows:

Gift to daughter		$100,000
Gift to husband		40,000
Total gifts during year		$140,000
Annual exclusion ($18,000 x 2)	$36,000	
Marital deduction ($40,000 - $18,000)	22,000	(58,000)
Taxable gifts		$82,000

Note: Charitable contributions are not subject to the gift tax. Thus, the contribution to her church is not subject to the gift tax. pp. I:1-8 and I:1-9.

I:1-43 a. The amount of Clay's taxable estate is $8,225,000. This amount is computed as follows:

Gross estate	$8,500,000
Minus: Funeral and Admin. Expenses	(125,000)
Debts	(150,000)
Taxable Estate	$8,225,000

b. The tax base for computing Clay's estate tax is $ 8,225,000, computed as follows:

Taxable estate	$8,225,000
Gifts after 1976	0
Estate tax base	$8,225,000

c. If the tentative estate tax is $3,235,800, no estate tax is due, computed as follows:

Estate tax from rate schedule	$3,235,800*
Minus: Unified tax credit (2024)	
based on an equivalent of $13,610,000	(5,389,800)
Estate tax due	$0

*[$345,800 + .40 (8,225,000 – 1,000,000)]

d. Yes, because the aggregate value of the estate decreased during the six-month period following the date of death, the alternate valuation date may be selected by the administrator. The important factors in deciding whether to use the alternate valuation date are (1) the amount of estate taxes to be saved, and (2) the impact on the beneficiaries' income tax

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situation. However, in this case, the alternate valuation date would not be necessary because the estate tax using date-of-death value is zero.

Note: There can never be a tax refund even if the unified credit is greater than the tax liability.

e. If the gross estate was $18,500,000, the taxable estate and tax base would be $18,225,000 ($18,500,000 - $125,000 - $150,000). The estate tax would be as follows:

Estate tax from rate schedule	$7,235,800
Minus: Unified tax credit (2024)	
based on an equivalent of $13,610,000	(5,389,800)
Estate tax due	$1,846,000

pp. I:1-9 and I:1-10.

I:1-44 a. The corporate tax liability of KT, Inc. for 2024 would be computed as follows:

Gross income	$2,000,000
Expenses: Operating expenses	(800,000)
Taxable income	$ 1,200,000
Corporation tax ($1,200,000 x 0.21)	$ 252,000

The tax liability of Keith and his wife on their individual return for 2024 is as follows:

Dividend from KT, Inc.	$350,000
Other taxable income	130,000
Adjusted Gross Income (AGI)	480,000
Itemized deductions	(40,000)
Taxable income	$440,000
Income tax (joint return rate schedule):	
Taxable income (above)	$440,000
Minus: dividends	(350,000)
Taxable income without dividends	$ 90,000
Tax from rate schedule on $90,000	$ 10,336
Tax on dividends ($350,000 x 15%*)	52,500
	$ 62,836

Thus, the total tax liability for both the corporation (Keith's share of 50%) and Keith and his wife is $188,836 ($126,000 + $62,836).

b. If the consulting business was organized as an LLC, the income taxes would be as follows:

KT, LLC	
Gross income	$2,000,000

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Operating expenses	(800,000)
Taxable income	$1,200,000
Income tax	$ 0

LLCs are flow-through entities and are not subject to income taxes on the entity.

The tax liability of Keith and his wife on their individual return for 2024 is as follows:

Pass-through income from KT, LLC ($1,200,000/2)	$600,000
Other taxable income	130,000
Adjusted gross income (AGI)	730,000
Itemized deductions	(40,000)
Taxable income	$690,000
Income tax (joint return rate schedule, rounded)*	$ 182,250

*Keith would also be subject to self-employment taxes on the $600,000 from KT, LLC. This amount is not shown in this problem. Self-employment taxes are covered later in this textbook.

In this case, as seen from the tax calculations above, when the consulting business is organized as an LLC, income taxes are decreased by $6,586, calculated as the difference between their tax as an LLC of $182,250 minus their tax as a C Corporation of $188,836. This results even though the dividends are taxed at a rate of 15%. Also, the $700,000 of LLC distributions ($350,000 each) are not subject to income taxation. pp. I:1-19 through I:1-23.

Note: This extremely simplified problem is intended to illustrate the effect of double taxation of C corporations and shareholders. Prior to 2018, the tax effect was much more significant. The reduction of C corporation tax rates to 21% (from 35%) has substantially reduced the tax advantage of flow-through entities. However, the 20% deduction for flow-through entities would further enhance the viability of flow-through entities.

I:1-45 Howard and Dawn's taxable income and income tax liability for 2024 is computed as follows:

Dawn's salary		$ 80,000
Allocable share of partnership income ($180,000 x 0.40)		72,000
Qualified dividends ($4,000 + $3,000)		7,000
Net long-term capital gain [($28,000 - $12,000) x 0.40]		6,400
Adjusted gross income (AGI)		$165,400
Larger of itemized deductions or standard deduction:		
Standard deduction, or	$29,200	
Itemized deductions:		
Mortgage interest	$13,000	

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Real estate taxes	6,000		
State and local income taxes	3,300		
Charitable contributions ($1,600 + $3,000)	4,600	26,600	(29,200)
Taxable income			$136,200

Income tax liability (from tax rate schedules, see calculations below)			$ 19,132*
Income tax payments made during the year:			
Tax withheld from salary		$12,500	
Estimated tax payments		10,000	22,000
Refund			$ 2,868

*$136,200 – (7,000 + 6,400) = 122,800; tax	$17,122
Dividends and LTCG: ($13,400 x 0.15)	2,010
Total tax liability	$19,132

Note: The cash distributions of $150,000 are not subject to income taxation for the partners. Also, Howard would likely be subject to self-employment taxes which are substantial. Self-employment taxes are covered in Chapter I:14 of this textbook.
pp. I:1-17 through I:1-19.

I:1-46 Since Paul's return is filed late and the final balance due on the return is paid late (both due on or before April 15, 2025), Paul is subject to further interest and penalties on his 2024 income tax return. Both interest and penalties are computed on the net tax due or, in this case, $8,000 (the difference between the tax liability and the withholdings). The interest and penalties are computed as follows (assuming a 7% interest rate on underpayments on tax and the return is 232 days late):

Interest: $8,000 x 7% x 232/365 = $355.95.

There are two penalties to which Paul would be subject, a failure to file (timely) penalty and a failure to pay the tax (timely) penalty. The late payment penalty is .5% per month to a maximum of 25%; the late filing penalty is 5% per month to a maximum of 25%. However, both penalties are not assessed together. If both penalties apply, the failure to file penalty is reduced by .5%.

Failure-to-pay penalty (0.5% per month to a maximum 25%):
Based on filing the return 9 months late:

Tax due	$8,000.00
Lesser of (a) 0.5% × 9 or (b) 25%	× 4.5%
Failure-to-pay penalty	$ 360.00

Failure-to-file penalty (5% per month to a maximum 25%, reduced by the failure-to-pay penalty for each month both penalties apply):

Tax due	$8,000.00
Lesser of (a) 5% × 9 or (b) 25%	× 25%
Failure-to-file penalty before reduction	$2,000.00

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Failure-to-pay penalty for 5 months*	(200.00)
Failure-to-file penalty	$1,800.00

*0.5% × 5 months × $8,000 = $200.00. Because the 5% per month penalty has a 25% maximum, it applied for only 5 months. See IRM Sec. 8.17.7.3.

Thus, Paul must pay an additional $355.95 of interest plus $2,160.00 ($360.00 + $1,800.00) of penalties for filing the return late, for a total cost of $2,515.95 for filing late. Obviously, Paul would be prudent to file his return in a timely manner. pp. I:1-28 and I:1-29.

I:1-47 a. Of the three individuals, Connie would most likely be audited. Individuals who have unincorporated businesses that produce significant tax losses are likely to get audited by the IRS.

b. Craig is not likely to be audited.

c. Dale is not likely to be audited. However, it is likely that the Form 1099 will be checked against the reported amount and the IRS Center will send Dale a bill for the corrected amount of tax. p. I:1-27.

I:1-48 The statute of limitations will not prevent the IRS from issuing a deficiency assessment for all three years of 2015, 2020, or 2022. Dan's taxes from 2015 can be assessed because the statute of limitations remains open indefinitely if no return is filed.

The $40,000 of unreported gross income from 2020 is taxable. A six-year statute of limitations applies if the taxpayer omits an item of gross income that is in excess of 25% of the reported gross income. In this case reported gross income was $60,000. $40,000 is greater than $15,000 (0.25 x $60,000).

The $600 unsubstantiated business travel deduction is disallowed in 2022 and gross income will be increased in 2022 because an assessment may be made against the taxpayer within three years from the later of the due date or the date the tax return was filed. In this case the omission occurred in 2022. p. I:1-28.

Tax Strategy and Critical Thinking Problem

I:1-49 Pedro is in a good position to begin a gifting program to his children. Since he has such a significant portfolio of stocks and bonds, he could make annual gifts of $18,000 of stocks and bonds in 2024 and future years to each of his children. The effect of these gifts is to shift the dividends and interest from Pedro (at his high rate) to the children (at their low rates) as well as removing these assets from Pedro's estate upon his death. Since the children have no income, the dividends and interest would be taxed to the older two children at the lowest marginal income tax rates.

As will be discussed in Chapter I:2 of this text, the children will be taxed at special rates for much of the income shifted to them per the so-called "kiddie tax." Thus, the shifting of investment income is not effective for children under the age of 18 (or 24 and in college). Also, Pedro and his wife can actually gift $36,000 ($18,000 x 2) per year for each child and over a few years, a sizeable amount of assets can be transferred to the children. To protect the assets, the gifts can be made to trusts rather than directly to the children to ensure that the children do not

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make bad decisions during their youthful years.

There are many other aspects of this type of tax strategy, but this problem is intended to demonstrate both the income and estate tax savings that can be accomplished through the making of annual gifts.

Case Study Problem

I:1-50

- The apartment buildings constitute a rental activity and are subject to the passive activity rules of Section 469 of the Internal Revenue Code. Since Rick's adjusted gross income (AGI) is greater than $150,000 before the loss, he would be unable to currently deduct the losses on his personal income tax return. Therefore, the $100,000 of losses in each of the first three years would not be deductible. However, the losses would be considered as suspended passive losses and would be available as a deduction against the rental income in future years.
- The blueberry farm, while requiring a substantial cash outlay, would not result in as much a loss as Rick believes. The reason is that most of the cash outlays must be capitalized and, if allowed, depreciated over several years rather than deducted currently. The land would not be depreciated at all. Both the equipment and blueberry plants must be capitalized and depreciated. So, while he may not get as much of a current deduction, he still would be able to claim the deductions in future years when the farm begins generating revenue.
- Rick is correct about using appreciated stock as a charitable contribution. If he gave his entire amount of stock to charitable organizations, he would receive a $200,000 charitable deduction in the year of the contribution. He would not be required to recognize any of the appreciation as income on his tax return. See Section 170 of the Internal Revenue Code for details.

Tax Research Problem

I:1-51 In CIR v. Court Holding Co. the main issue was whether the petitioner should have been taxed on the gain realized on the sales of all its assets, or whether the sale was made by its stockholders individually after distribution of the assets to them in complete liquidation. The sole asset in the corporation was an apartment house. All of the outstanding stock was owned by a husband and wife. Negotiations took place between the corporation, a sister and brother-in-law, and lessees of the building to sell the property. Just prior to putting the sale in writing, the corporation's attorney advised the husband and wife that this sale would cause a large tax to the corporation. The next day the corporation declared a "liquidating dividend" which deeded the property to the husband and wife, who in turn surrendered all of their stock. A sales contract was then drawn between the husband and wife and the lessees of the building for sale of the property. The $1,000 that was previously paid to the corporation was given to the husband and wife as a down payment. The property was then conveyed to the lessees.

The Tax Court found that the corporation had not abandoned the sales negotiations. "A sale by one person cannot be transferred for tax purposes into a sale by another by using the latter as a conduit through which to pass title." The Supreme Court upheld the Tax Court's

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findings that the sale was actually a sale by the corporation and the necessary taxes were imposed. The Supreme Court held that the incidence of the transaction depends upon the "substance" of the transaction and that the separate steps previously described should be viewed as a whole transaction.

In U.S. v. Cumberland Public Service Co. the issue was essentially the same. Who actually made the sale, the corporation or the shareholders? The Cumberland Public Service Company was in the business of generating and distributing electric power. A local cooperative began to distribute power in the area serviced by Cumberland. The competing company had more efficient means of generating electricity. Cumberland offered to sell all of its stock to the competing company. The company refused the offer but countered with an offer to buy the transmission and distribution equipment of Cumberland. Cumberland refused because under such a deal it would have been subject to a heavy capital gains tax. Shareholders of Cumberland offered to buy the corporate property and then sell the property to the competing corporation. The Court of Claims found that the shareholders did actually make the sale and that at no time was the corporation ever planning to make such a sale. In addition, the court held that the liquidation and dissolution genuinely ended the corporation's activities and existence. The Supreme Court upheld the Court of Claims findings.

While the Court Holding Co. and Cumberland Public Service Co. cases appear to revolve around very similar facts, the courts have ruled that the steps of such transactions must be explored as well as the end result. The Cumberland Public Service Company was able to show that the liquidation and dissolution genuinely ended the corporation's activities and existence so that the shareholders acted on their own behalf when they executed the previously contemplated sale to the cooperative.

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Chapter I:1

An Introduction to Taxation

Learning Objectives

After studying this chapter, the student should be able to:

1. Discuss the history of taxation in the United States.
2. Describe the three types of tax rate structures.
3. Describe the various types of taxes.
4. Discuss the criteria for a "good" tax structure, the objectives of the federal income tax law, and recent tax reform proposals.
5. Describe the tax entities in the federal income tax system.
6. Identify the various tax law sources and understand their implications for tax practice.
7. Describe the legislative process for the enactment of the tax law.
8. Describe the administrative procedures under the tax law.
9. Describe the components of a tax practice.
10. Understand the importance of computer applications in taxation.

Areas of Greater Significance

1. For an introductory course in taxation, two of the topics in this chapter should be emphasized. The first topic to be emphasized is the sources of tax law (both primary and secondary). The student should understand that in spite of the black and white rule approach in much of the following material, a tax practitioner may spend a considerable amount of time dealing with issues that are not clear cut.
2. Second, the administration of the tax law should be emphasized. An understanding of how the Internal Revenue Service operates is valuable to each student, even if the only future application is with regard to the student's own individual tax return.

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Areas of Lesser Significance

In the interest of time, the instructor may determine that the following areas are best covered by student reading, rather than class discussion:

1. History of Taxation in the United States
2. Other Types of Taxes
3. Criteria for a Tax Structure
4. Objectives of the Federal Income Tax Law

Problem Areas for Students

The following areas may prove especially difficult for students:

1. The relative weight to be given to various governmental interpretations of the tax law (i.e., Treasury Regulations vs. Tax Court cases).
2. The mechanics and thought process in doing tax research. An instructor who will use tax research as a significant pedagogical tool may want to spend considerable time on the topic at this point. It is very difficult for a student to understand tax research without doing tax research. (See Chapter I:15.)

Highlights of Recent Tax Law Changes

The following items of tax law have changed since the 2024 edition of this chapter:

1. The income levels for tax rates for ordinary income, long-term capital gains, dividend income, and income of estates and trusts have increased. (See Quick Reference.)
2. The ceiling amount for paying the full amount of payroll taxes has increased to $168,600 ($160,200 in 2023).
3. The annual exclusion for gifts has increased to $18,000 ($17,000 in 2023).
4. The unified transfer tax equivalent has increased to $13,610,000 ($12,920,000 in 2023).
5. The standard deduction for each filing status has increased. (See Quick Reference.)

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Teaching Tips

1. If you want to teach tax research in the introductory class, it would be best to assign a comprehensive tax research problem to solidify concepts taught in class.

2. When teaching tax law sources, it is important to clarify to the students the relative priority of the many different sources.

Lecture Outline

I. Types of Tax Rate Structures

1. The Structure of Individual Income Tax Rates (Example I:1-1, I:1-2)

    a. Possible tax rate structures are progressive, proportional (flat tax), or regressive. The current federal tax system is progressive (10%-37%).

2. Corporate Tax Rates

    a. The tax rate for regular corporations (C corporations) is flat (21%).

3. Marginal, Average, and Effective Tax Rates for Taxpayers (Example I:1-4, I:1-5)

    a. Marginal tax rates may vary significantly from the nominal schedule rates. For example, even though the nominal maximum individual rate is 37%, the realized marginal rate is higher because of health care taxes.

    b. Because the federal income tax for individuals is progressive, average tax is always below marginal tax.

    c. Effective tax rates are likely the lowest of the three calculations because economic income exceeds taxable income.

4. Determination of Taxable Income and Tax Due

    a. Taxable income for all types of taxpayers is calculated by subtracting allowable exclusions and deductions from total income. The tax or refund due is calculated by subtracting allowable credits and/or prepayments from the gross tax liability resulting from applying applicable tax rates to taxable income.

II. Entities in the Federal Income Tax System

1. Taxpaying entities are individuals (Example I:1-13) and C corporations (Example I:1-14). If trusts and estates do not fully distribute their taxable income, they may pay tax.

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2. Flow-through entities are sole proprietorships, partnerships (Example I:1-18), S corporations, limited liability companies and limited liability partnerships, and trusts and estates (to the extent that the trust's or estate's income is distributed) (Example I:1-23).

III. Tax Law Sources (Topic Review I:1-3; Instructor Aid I:1-1)

1. Legislative tax law sources include the Internal Revenue Code and Congressional Committee Reports.

2. Executive (Administrative) tax law sources include proposed, temporary, and final Treasury regulations and IRS revenue rulings, revenue procedures, private letter rulings, technical advice memoranda, and information releases.

3. Judicial tax law sources include various levels of court decisions.

IV. Enactment of a Tax Law (Table I:1-2)

1. The procedures for enactment of tax legislation are the same as those for any other federal legislation, with the exception that all revenue measures are constitutionally required to be introduced in the House of Representatives. These procedures include deliberations by the House Ways and Means Committee, the Senate Finance Committee, and the Joint Conference Committee. The committee reports produced during these deliberations are valuable sources of legislative intent used in governmental and taxpayer interpretation of the enacted legislation.

2. The political process affects tax legislation as it proceeds through the House of Representatives and the Senate toward the President's signature. The economic, social, and revenue priorities of the legislators (and their constituencies) affect the final product. Also, efforts to reduce the budget deficit in recent years have had an impact on annual tax legislation.

V. Administration of the Tax Law and Tax Practice Issues (Instructor Aid I:1-2)

1. Organization of the Internal Revenue Service

    a. Important personnel in the IRS (in descending authority) are the Commissioner of the Internal Revenue, deputy and assistant commissioners, regional commissioners, and district directors.

    b. Unresolved disputes between taxpayers and the IRS may result in litigation. Tax litigation in Tax Court is handled by the office of the Chief Counsel. Tax litigation in a U.S. District Court and the U.S. Claims Court is handled by attorneys in the Department of Justice.

2. Selection of Returns for Audit (Example I:1-25; Question I:1-29)

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a. With the use of computer analysis and professional judgment, taxpayer returns are selected for additional correspondence, office audit, or field audit. Mathematical errors and certain matching problems (e.g., the amount of interest on a Form 1099 received by the IRS does not match the amount of interest reported by the taxpayer) can generally be resolved by correspondence.

b. In an office audit, the taxpayer is asked to bring documentation to the IRS office to substantiate income, deduction, and/or credit items on the taxpayer's return. More complex audits are handled by a field audit where the IRS agent goes to the taxpayer's place of business or to the office of the taxpayer's tax professional.

c. Disputes between IRS agents and taxpayers may be resolved with the IRS Appeals Division. While the overall individual audit rate is less than 1%, individuals with relatively large amounts of income and deductions are significantly more likely to be audited. If a return contains a frequently disputed item (e.g., home office deduction), the likelihood of audit also increases.

3. Statute of Limitations (Problem I:1-48)

a. The normal statute of limitations (i.e., how long the IRS has to examine the return) is three years from the due date of the return (or when the return is actually filed if late). The statute of limitations is extended to six years if more than 25% of gross income is omitted on the return. There is no statute of limitations if the taxpayer committed fraud or failed to file a return.

b. The applicable statute of limitations may be extended by mutual agreement between the taxpayer and the government. Reticent taxpayers are encouraged to extend the statute of limitations when the alternative is an immediate unfavorable notice of deficiency. These varying lengths of statutes of limitation also cause a record-keeping problem for taxpayers. How can a taxpayer disprove an IRS claim of fraud without keeping tax records indefinitely?

4. Interest and Penalties (Example I:1-27)

a. Interest and penalties may apply to taxes due and other taxpayer noncompliance. The deductibility of interest paid will be determined under the normal interest deductions rules. Penalties for failure to file, failure to pay, negligence, fraud, etc., are not tax deductible.

VI. Components of a Tax Practice

1. Tax Compliance and Procedures

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a. The preparation of tax returns remains a major component of most tax practices. Some major firms have a separate department to deal with tax compliance.

2. Tax Research

   a. The tax research process involves determination of the facts, identification of the problem, determination of the best solution and communication to the client. (See Chapter I:15 for an in-depth discussion of tax research.)

3. Tax Planning and Consulting

   a. Much of the tax professional's value to a client may be in the planning and consulting areas. Minimizing taxes paid and maximizing after-tax cash flows, while accommodating clients' desires, is a much sought-after commodity in today's complex tax environment.

4. Financial Planning

   a. Some tax professionals have added financial planning to their list of services offered. Items analyzed include insurance coverage, investment strategies, and retirement planning.

Court Case Briefs

Alfred Ficalora v. CIR, 55 AFTR 2d 85-473, 85-1 USTC & 9103 (2nd Cir., 1984).

In 1980, an employee of the New York telephone company challenged the constitutional authority of Congress and the Tax Court to impose a direct tax on his wages without apportionment to the States. He cited Article I, Section 9, clause 4 of the U.S. Constitution which prohibits a direct tax without apportionment. The taxpayer further relied on the case of *Pollock v. Farmer's Loan and Trust Co.*, 3 AFTR 2602, 15 S. Ct. 912 (USSC, 1895) which states that a tax on the income from real and personal property was invalid without apportionment.

The Supreme Court in *Pollock*, however, had stated explicitly that a tax on one's employment was not a direct tax and did not require apportionment. Further, the Sixteenth Amendment to the U.S. Constitution gave Congress the authority to tax income without apportionment. The court found that the taxpayer had ignored the developments in Constitutional law over the last ninety years and upheld the deficiency and penalties assessed against him.

Walter G. Pietsch v. CIR, 26 AFTR 2d 70-5847, 70-2 USTC & 9718 (2nd Cir., 1970).

Mr. Pietsch filed his 1968 income tax return, but denied liability for the portion of the tax that was associated with funding the military operation of the United States in the Vietnam conflict.

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The taxpayer sought a declaration from the court that American participation in Vietnam was unconstitutional and asked the court to enjoin the federal officials from collecting the tax.

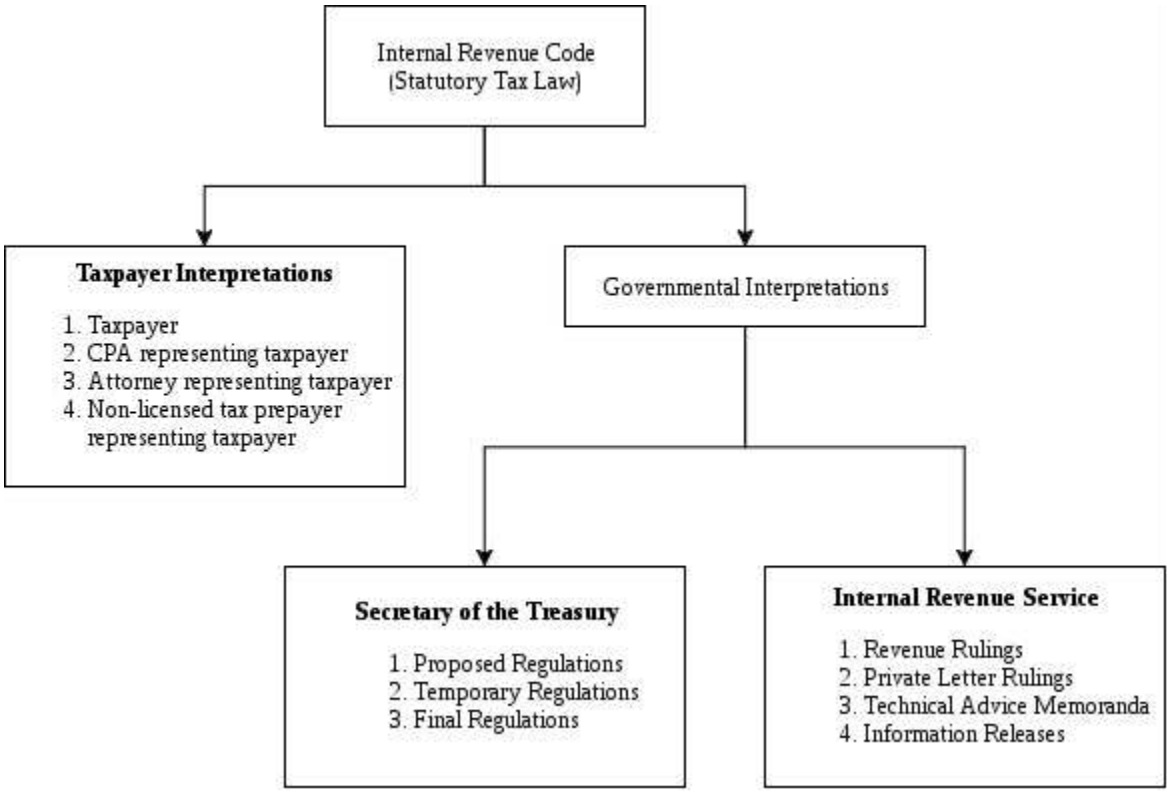
The suit was dismissed for failure to state a claim (the taxpayer had not yet paid the tax). The court stated further that Mr. Pietsch was most unlikely to prevail in a refund suit (commenced after the tax was paid) because he did not attack the validity of the tax itself, but rather the use of it.

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Instructor Aid I:1-1

Tax Law Interpretations

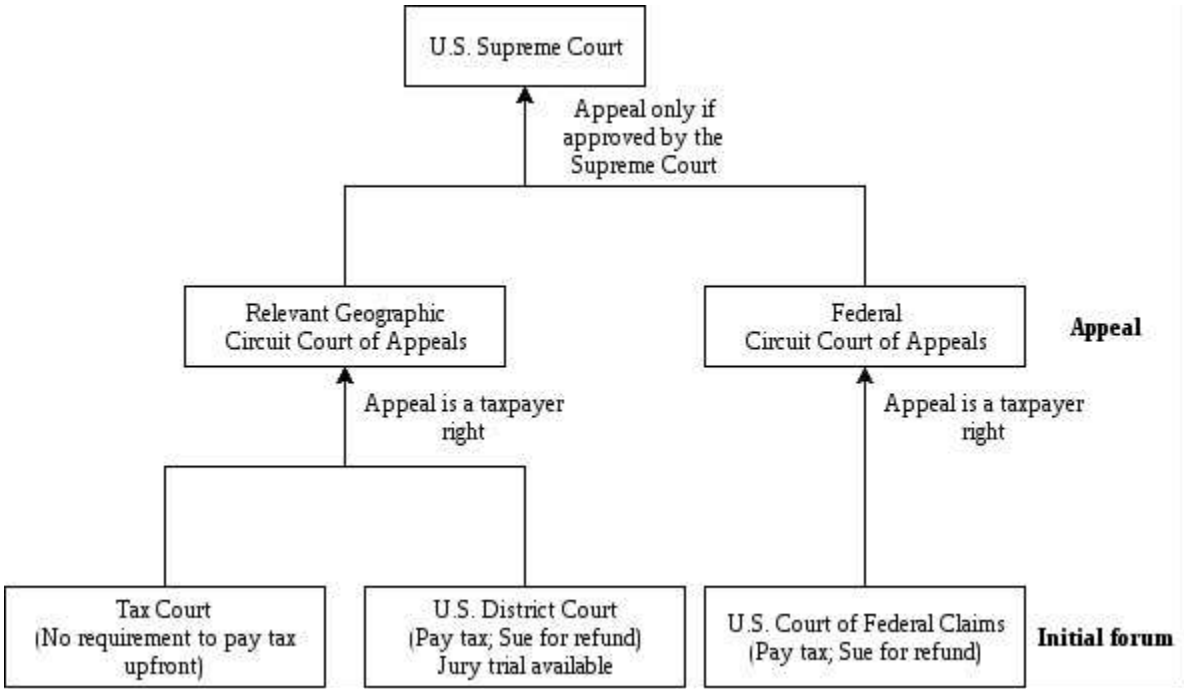


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Instructor Aid I:1-2

Tax Litigation from the Taxpayer Perspective



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Form **1040** Department of the Treasury—Internal Revenue Service **U.S. Individual Income Tax Return** **2023** OMB No. 1545-0074 IRS Use Only—Do not write or stapled in this space.

For the year Jan. 1–Dec. 31, 2023, or other tax year beginning _____, 2023, ending _____, 20____ See separate instructions.

Your first name and middle initial: Zachary L.	Last name: Mao	Your social security number: 123 45 6789
If joint return, spouse's first name and middle initial: Cici K.	Last name: Mao	Spouse's social security number: 987 65 4321
Home address (number and street). If you have a P.O. box, see instructions.: 520 Chestnut St.	Apt. no.	Presidential Election Campaign: Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
City, town, or post office. If you have a foreign address, also complete spaces below.: Philadelphia	State: PA	ZIP code: 19106
Foreign country name	Foreign province/state/county	Foreign postal code

Filing Status Check only one box.
☐ Single ☐ Head of household (HOH)
☑ Married filing jointly (even if only one had income)
☐ Married filing separately (MFS) ☐ Qualifying surviving spouse (QSS)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent: _____

Digital Assets At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) ☐ Yes ☑ No

Standard Deduction **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1959 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1959 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here ☐

(1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) Child tax credit	(4) Credit for other dependents
Oliver	Mao	111 22 3333	Son	☑	☐
				☐	☐
				☐	☐
				☐	☐

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld. If you did not get a Form W-2, see instructions.

1a	Total amount from Form(s) W-2, box 1 (see instructions)				1a	85,000*
b	Household employee wages not reported on Form(s) W-2				1b	
c	Tip income not reported on line 1a (see instructions)				1c	
d	Medicaid waiver payments not reported on Form(s) W-2 (see instructions)				1d	
e	Taxable dependent care benefits from Form 2441, line 26				1e	
f	Employer-provided adoption benefits from Form 8839, line 29				1f	
g	Wages from Form 8919, line 6				1g	
h	Other earned income (see instructions)				1h	
i	Nontaxable combat pay election (see instructions)	1i				
z	Add lines 1a through 1h				1z	85,000
2a	Tax-exempt interest	2a		b Taxable interest	2b	58
3a	Qualified dividends	3a		b Ordinary dividends	3b	
4a	IRA distributions	4a		b Taxable amount	4b	
5a	Pensions and annuities	5a		b Taxable amount	5b	
6a	Social security benefits	6a		b Taxable amount	6b	
c	If you elect to use the lump-sum election method, check here (see instructions) ☐					
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ☐				7	
8	Additional income from Schedule 1, line 10				8	
9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income**				9	85,058
10	Adjustments to income from Schedule 1, line 26				10	
11	Subtract line 10 from line 9. This is your **adjusted gross income**				11	85,058
12	**Standard deduction or itemized deductions** (from Schedule A)				12	27,700
13	Qualified business income deduction from Form 8995 or Form 8995-A				13	
14	Add lines 12 and 13				14	27,700
15	Subtract line 14 from line 11. If zero or less, enter -0-. This is your **taxable income**				15	57,358

Attach Sch. B if required.

Standard Deduction for—
- Single or Married filing separately, $13,850
- Married filing jointly or Qualifying surviving spouse, $27,700
- Head of household, $20,800
- If you checked any box under *Standard Deduction*, see instructions.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2023)

* $40,000 + $45,000

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Form 1040 (2023) Page **2**

Tax and Credits	16	**Tax** (see instructions). Check if any from Form(s): **1** ☐ 8814 **2** ☐ 4972 **3** ☐		16	6,445*
	17	Amount from Schedule 2, line 3		17	
	18	Add lines 16 and 17		18	6,445
	19	Child tax credit or credit for other dependents from Schedule 8812		19	2,000
	20	Amount from Schedule 3, line 8		20	
	21	Add lines 19 and 20		21	2,000
	22	Subtract line 21 from line 18. If zero or less, enter -0-		22	4,445
	23	Other taxes, including self-employment tax, from Schedule 2, line 21		23	
	24	Add lines 22 and 23. This is your **total tax**		24	4,445
Payments	25	Federal income tax withheld from:			
	a	Form(s) W-2	25a 5,600		
	b	Form(s) 1099	25b		
	c	Other forms (see instructions)	25c		
	d	Add lines 25a through 25c		25d	5,600
If you have a qualifying child, attach Sch. EIC.	26	2023 estimated tax payments and amount applied from 2022 return		26	
	27	Earned income credit (EIC)	27		
	28	Additional child tax credit from Schedule 8812	28		
	29	American opportunity credit from Form 8863, line 8	29		
	30	Reserved for future use	30		
	31	Amount from Schedule 3, line 15	31		
	32	Add lines 27, 28, 29, and 31. These are your **total other payments and refundable credits**		32	
	33	Add lines 25d, 26, and 32. These are your **total payments**		33	5,600
Refund	34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**		34	1,155
	35a	Amount of line 34 you want **refunded to you**. If Form 8888 is attached, check here ☐		35a	1,155
Direct deposit? See instructions.	b	Routing number 0 1 2 3 4 5 6 7 8 **c** Type: ☑ Checking ☐ Savings			
	d	Account number 5 5 5 6 6 6 7 * *			
	36	Amount of line 34 you want **applied to your 2024 estimated tax**	36		
Amount You Owe	37	Subtract line 33 from line 24. This is the **amount you owe**. For details on how to pay, go to *www.irs.gov/Payments* or see instructions		37	
	38	Estimated tax penalty (see instructions)	38		

Third Party Designee Do you want to allow another person to discuss this return with the IRS? See instructions ☐ **Yes.** Complete below. ☑ **No** * *

Designee's name | Phone no. | Personal identification number (PIN)

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Manager	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)
		Teacher	
Phone no.	Email address		

Joint return? See instructions. Keep a copy for your records.

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name			Phone no.	
Firm's address			Firm's EIN	

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2023)

* From 2023 Tax Table.

** This information is not included in the problem's facts, but it is included here for completeness. Instructors may want to provide this or similar information to students when assigning this problem.

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SCHEDULE 8812 (Form 1040)

Department of the Treasury
Internal Revenue Service

Credits for Qualifying Children and Other Dependents

Attach to Form 1040, 1040-SR, or 1040-NR.

Go to *www.irs.gov/Schedule8812* for instructions and the latest information.

OMB No. 1545-0074

2023

Attachment Sequence No. **47**

Name(s) shown on return: Zachary L. and Cici K. Mao

Your social security number: 123 | 45 | 6789

Part I Child Tax Credit and Credit for Other Dependents

1	Enter the amount from line 11 of your Form 1040, 1040-SR, or 1040-NR		1	85,058
2a	Enter income from Puerto Rico that you excluded	2a		
b	Enter the amounts from lines 45 and 50 of your Form 2555	2b		
c	Enter the amount from line 15 of your Form 4563	2c		
d	Add lines 2a through 2c		2d	
3	Add lines 1 and 2d		3	85,058
4	Number of qualifying children under age 17 with the required social security number	4	1	
5	Multiply line 4 by $2,000		5	2,000
6	Number of other dependents, including any qualifying children who are not under age 17 or who do not have the required social security number	6		
	Caution: Do not include yourself, your spouse, or anyone who is not a U.S. citizen, U.S. national, or U.S. resident alien. Also, do not include anyone you included on line 4.			
7	Multiply line 6 by $500		7	
8	Add lines 5 and 7		8	2,000
9	Enter the amount shown below for your filing status. • Married filing jointly—$400,000 • All other filing statuses—$200,000		9	400,000
10	Subtract line 9 from line 3. • If zero or less, enter -0-. • If more than zero and not a multiple of $1,000, enter the next multiple of $1,000. For example, if the result is $425, enter $1,000; if the result is $1,025, enter $2,000, etc.		10	-0-
11	Multiply line 10 by 5% (0.05)		11	-0-
12	Is the amount on line 8 more than the amount on line 11?		12	2,000
	☐ **No. STOP.** You cannot take the child tax credit, credit for other dependents, or additional child tax credit. Skip Parts II-A and II-B. Enter -0- on lines 14 and 27.			
	☑ **Yes.** Subtract line 11 from line 8. Enter the result.			
13	Enter the amount from **Credit Limit Worksheet A**		13	6,445*
14	Enter the smaller of line 12 or line 13. **This is your child tax credit and credit for other dependents Enter this amount on Form 1040, 1040-SR, or 1040-NR, line 19.**		14	2,000

If the amount on line 12 is more than the amount on line 14, you may be able to take the **additional child tax credit** on Form 1040, 1040-SR, or 1040-NR, line 28. Complete your Form 1040, 1040-SR, or 1040-NR through line 27 (also complete Schedule 3, line 11) before completing Part II-A.

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59761M **Schedule 8812 (Form 1040) 2023**

* Credit Limit Worksheet A:

1. Amount from line 18 of Form 1040	6,445
2. Amounts from various lines on Schedule 3	-0-
3. Subtract line 2 from line 1	6,445
4. If you are not completing Credit Limit Worksheet B, enter -0-	-0-
5. Subtract line 4 from line 3. Enter here and an Schedule 8812, line 13	6,445

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Part II-A Additional Child Tax Credit for All Filers

Caution: If you file Form 2555, you cannot claim the additional child tax credit.

15	Check this box if you **do not** want to claim the additional child tax credit. Skip Parts II-A and II-B. Enter -0- on line 27		☐
16a	Subtract line 14 from line 12. If zero, **stop here**; you cannot take the additional child tax credit. Skip Parts II-A and II-B. Enter -0- on line 27	16a	-0-
b	Number of qualifying children under 17 with the required social security number: _____ x $1,600. Enter the result. If zero, **stop here**; you cannot claim the additional child tax credit. Skip Parts II-A and II-B. Enter -0- on line 27	16b	
	TIP: The number of children you use for this line is the same as the number of children you used for line 4.		
17	Enter the **smaller** of line 16a or line 16b	17	
18a	Earned income (see instructions)	18a	
b	Nontaxable combat pay (see instructions) 18b		
19	Is the amount on line 18a more than $2,500? ☐ **No.** Leave line 19 blank and enter -0- on line 20. ☐ **Yes.** Subtract $2,500 from the amount on line 18a. Enter the result	19	
20	Multiply the amount on line 19 by 15% (0.15) and enter the result	20	
	Next. On line 16b, is the amount $4,800 or more? ☐ **No.** If you are a bona fide resident of Puerto Rico, go to line 21. Otherwise, skip Part II-B and enter the **smaller** of line 17 or line 20 on line 27. ☐ **Yes.** If line 20 is equal to or more than line 17, skip Part II-B and enter the amount from line 17 on line 27. Otherwise, go to line 21.		

Part II-B Certain Filers Who Have Three or More Qualifying Children and Bona Fide Residents of Puerto Rico

21	Withheld social security, Medicare, and Additional Medicare taxes from Form(s) W-2, boxes 4 and 6. If married filing jointly, include your spouse's amounts with yours. If your employer withheld or you paid Additional Medicare Tax or tier 1 RRTA taxes, or if you are a bona fide resident of Puerto Rico, see instructions	21	
22	Enter the total of the amounts from Schedule 1 (Form 1040), line 15; Schedule 2 (Form 1040), line 5; Schedule 2 (Form 1040), line 6; and Schedule 2 (Form 1040), line 13	22	
23	Add lines 21 and 22	23	
24	**1040 and 1040-SR filers:** Enter the total of the amounts from Form 1040 or 1040-SR, line 27, and Schedule 3 (Form 1040), line 11. **1040-NR filers:** Enter the amount from Schedule 3 (Form 1040), line 11.	24	
25	Subtract line 24 from line 23. If zero or less, enter -0-	25	
26	Enter the **larger** of line 20 or line 25 **Next**, enter the **smaller** of line 17 or line 26 on line 27.	26	

Part II-C Additional Child Tax Credit

27	**This is your additional child tax credit. Enter this amount on Form 1040, 1040-SR, or 1040-NR, line 28**	27	-0-

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Form **1040-SR** Department of the Treasury—Internal Revenue Service **U.S. Tax Return for Seniors** | **2023** | OMB No. 1545-0074 | IRS Use Only—Do not write or stapple in this space.

For the year Jan. 1–Dec. 31, 2023, or other tax year beginning _____, 2023, ending _____, 20 _____ | See separate instructions.

Your first name and middle initial: John R.	Last name: Lane	**Your social security number:** 111 44 6666
If joint return, spouse's first name and middle initial	Last name	**Spouse's social security number**

Home address (number and street). If you have a P.O. box, see instructions. 1010 Ipsen St. | Apt. no.

City, town, or post office. If you have a foreign address, also complete spaces below. Yorba Linda | State: CA | ZIP code: 90102

Foreign country name | Foreign province/state/county | Foreign postal code

Presidential Election Campaign
Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund.
☑ **You** ☐ **Spouse**

Filing Status * Check only one box.
☑ Single ☐ Married filing jointly (even if only one had income) ☐ Married filing separately (MFS)
☐ Head of household (HOH) ☐ Qualifying surviving spouse (QSS)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent: _____

Digital Assets
At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) . . . . . ☐ **Yes** ☑ **No**

Standard Deduction
Someone can claim: ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness
You: ☑ Were born before January 2, 1959 ☐ Are blind
Spouse: ☐ Was born before January 2, 1959 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here ☐

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) Check the box if qualifies for (see instructions): Child tax credit	Credit for other dependents
			☐	☐
			☐	☐
			☐	☐
			☐	☐

Income
Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.
If you did not get a Form W-2, see instructions.

1a	Total amount from Form(s) W-2, box 1 (see instructions)					1a	50,000
b	Household employee wages not reported on Form(s) W-2					1b	
c	Tip income not reported on line 1a (see instructions)					1c	
d	Medicaid waiver payments not reported on Form(s) W-2 (see instructions)					1d	
e	Taxable dependent care benefits from Form 2441, line 26					1e	
f	Employer-provided adoption benefits from Form 8839, line 29					1f	
g	Wages from Form 8919, line 6					1g	
h	Other earned income (see instructions)					1h	
i	Nontaxable combat pay election (see instructions)	1i					
z	Add lines 1a through 1h					1z	50,000
2a	Tax-exempt interest	2a		b	Taxable interest	2b	240
3a	Qualified dividends	3a		b	Ordinary dividends	3b	
4a	IRA distributions	4a		b	Taxable amount	4b	
5a	Pensions and annuities	5a	41,000	b	Taxable amount	5b	41,000
6a	Social security benefits	6a		b	Taxable amount	6b	
c	If you elect to use the lump-sum election method, check here (see instructions) ☐						

Attach Schedule B if required.

* John does not qualify as a head of household because his cousin is not his dependent (his cousin fails the relationship test for a qualifying child, as well as the relationship test for a qualifying individual).

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	7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ☐	7	
	8	Additional income from Schedule 1, line 10	8	
	9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income**	9	91,240
	10	Adjustments to income from Schedule 1, line 26	10	6,500
	11	Subtract line 10 from line 9. This is your **adjusted gross income**	11	84,740
Standard Deduction See *Standard Deduction Chart* on the last page of this form.	12	**Standard deduction or itemized deductions** (from Schedule A)	12	15,700*
	13	Qualified business income deduction from Form 8995 or Form 8995-A	13	
	14	Add lines 12 and 13	14	15,700
	15	Subtract line 14 from line 11. If zero or less, enter -0-. This is your **taxable income**	15	69,040
Tax and Credits	16	**Tax** (see instructions). Check if any from: **1** ☐ Form(s) 8814 **2** ☐ Form(s) 4972 **3** ☐ _____	16	10,493**
	17	Amount from Schedule 2, line 3	17	
	18	Add lines 16 and 17	18	10,493
	19	Child tax credit or credit for other dependents from Schedule 8812	19	
	20	Amount from Schedule 3, line 8	20	
	21	Add lines 19 and 20	21	
	22	Subtract line 21 from line 18. If zero or less, enter -0-	22	10,493
	23	Other taxes, including self-employment tax, from Schedule 2, line 21	23	
	24	Add lines 22 and 23. This is your **total tax**	24	10,493
Payments	25	Federal income tax withheld from:		
	a	Form(s) W-2 — 25a: 12,100		
	b	Form(s) 1099 — 25b:		
	c	Other forms (see instructions) — 25c:		
	d	Add lines 25a through 25c	25d	12,100
	26	2023 estimated tax payments and amount applied from 2022 return	26	
If you have a qualifying child, attach Sch. EIC.	27	Earned income credit (EIC) — 27:		
	28	Additional child tax credit from Schedule 8812 — 28:		
	29	American opportunity credit from Form 8863, line 8 — 29:		
	30	Reserved for future use — 30:		
	31	Amount from Schedule 3, line 15 — 31:		
	32	Add lines 27, 28, 29, and 31. These are your **total other payments and refundable credits**	32	
	33	Add lines 25d, 26, and 32. These are your **total payments**	33	12,100

* From Standard Deduction Chart on page 4 of Form 1040-SR.

** From 2023 Tax Table.

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Form 1040-SR (2023) Page **3**

Refund

34 If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid** **34** 1,607

35a Amount of line 34 you want **refunded to you**. If Form 8888 is attached, check here . . . . . ☐ **35a** 1,607

Direct deposit? See instructions.

b Routing number 0 1 2 3 4 5 6 7 8 **c** Type: ☑ Checking ☐ Savings

d Account number 5 5 5 6 6 6 7 *

36 Amount of line 34 you want **applied to your 2024 estimated tax** **36**

Amount You Owe

37 Subtract line 33 from line 24. This is the **amount you owe**. For details on how to pay, go to *www.irs.gov/Payments* or see instructions **37**

38 Estimated tax penalty (see instructions) **38**

Third Party Designee

Do you want to allow another person to discuss this return with the IRS? See instructions . . . . . ☐ **Yes.** Complete below. ☑ **No** *

Designee's name | Phone no. | Personal identification number (PIN)

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Retired	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)

Phone no. | Email address

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name			Phone no.	
Firm's address			Firm's EIN	

Go to *www.irs.gov/Form1040SR* for instructions and the latest information. Form **1040-SR** (2023)

* This information is not included in the problem's facts, but it is included here for completeness. Instructors may want to provide this or similar information to students when assigning this problem.

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Standard Deduction Chart*

Add the number of boxes checked in the "Age/Blindness" section of *Standard Deduction* on page 1 . . . . .

IF your filing status is. . .	AND the number of boxes checked is. . .	THEN your standard deduction is. . .
Single	1	$15,700
	2	17,550
Married filing jointly	1	$29,200
	2	30,700
	3	32,200
	4	33,700
Qualifying surviving spouse	1	$29,200
	2	30,700
Head of household	1	$22,650
	2	24,500
Married filing separately**	1	$15,350
	2	16,850
	3	18,350
	4	19,850

*Don't use this chart if someone can claim you (or your spouse if filing jointly) as a dependent, your spouse itemizes on a separate return, or you were a dual-status alien. Instead, see instructions.

**You can check the boxes for your spouse if your filing status is married filing separately and your spouse had no income, isn't filing a return, and can't be claimed as a dependent on another person's return.

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SCHEDULE 1 (Form 1040)

Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074

2023

Attachment Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR	**Your social security number**
John R. Lane	111-44-6666

Part I Additional Income

1	Taxable refunds, credits, or offsets of state and local income taxes			1	
2a	Alimony received			2a	
b	Date of original divorce or separation agreement (see instructions): _____				
3	Business income or (loss). Attach Schedule C			3	
4	Other gains or (losses). Attach Form 4797			4	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			5	
6	Farm income or (loss). Attach Schedule F			6	
7	Unemployment compensation			7	
8	Other income:				
a	Net operating loss	8a	( )		
b	Gambling	8b			
c	Cancellation of debt	8c			
d	Foreign earned income exclusion from Form 2555	8d	( )		
e	Income from Form 8853	8e			
f	Income from Form 8889	8f			
g	Alaska Permanent Fund dividends	8g			
h	Jury duty pay	8h			
i	Prizes and awards	8i			
j	Activity not engaged in for profit income	8j			
k	Stock options	8k			
l	Income from the rental of personal property if you engaged in the rental for profit but were not in the business of renting such property	8l			
m	Olympic and Paralympic medals and USOC prize money (see instructions)	8m			
n	Section 951(a) inclusion (see instructions)	8n			
o	Section 951A(a) inclusion (see instructions)	8o			
p	Section 461(l) excess business loss adjustment	8p			
q	Taxable distributions from an ABLE account (see instructions)	8q			
r	Scholarship and fellowship grants not reported on Form W-2	8r			
s	Nontaxable amount of Medicaid waiver payments included on Form 1040, line 1a or 1d	8s	( )		
t	Pension or annuity from a nonqualifed deferred compensation plan or a nongovernmental section 457 plan	8t			
u	Wages earned while incarcerated	8u			
z	Other income. List type and amount: _____ _____	8z			
9	Total other income. Add lines 8a through 8z			9	
10	Combine lines 1 through 7 and 9. This is your **additional income**. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8			10	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F **Schedule 1 (Form 1040) 2023**

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Part II Adjustments to Income

11	Educator expenses		11	
12	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106		12	
13	Health savings account deduction. Attach Form 8889		13	
14	Moving expenses for members of the Armed Forces. Attach Form 3903		14	
15	Deductible part of self-employment tax. Attach Schedule SE		15	
16	Self-employed SEP, SIMPLE, and qualified plans		16	
17	Self-employed health insurance deduction		17	
18	Penalty on early withdrawal of savings		18	
19a	Alimony paid		19a	
b	Recipient's SSN			
c	Date of original divorce or separation agreement (see instructions):			
20	IRA deduction		20	6,500
21	Student loan interest deduction		21	
22	Reserved for future use		22	
23	Archer MSA deduction		23	
24	Other adjustments:			
a	Jury duty pay (see instructions)	24a		
b	Deductible expenses related to income reported on line 8l from the rental of personal property engaged in for profit	24b		
c	Nontaxable amount of the value of Olympic and Paralympic medals and USOC prize money reported on line 8m	24c		
d	Reforestation amortization and expenses	24d		
e	Repayment of supplemental unemployment benefits under the Trade Act of 1974	24e		
f	Contributions to section 501(c)(18)(D) pension plans	24f		
g	Contributions by certain chaplains to section 403(b) plans	24g		
h	Attorney fees and court costs for actions involving certain unlawful discrimination claims (see instructions)	24h		
i	Attorney fees and court costs you paid in connection with an award from the IRS for information you provided that helped the IRS detect tax law violations	24i		
j	Housing deduction from Form 2555	24j		
k	Excess deductions of section 67(e) expenses from Schedule K-1 (Form 1041)	24k		
z	Other adjustments. List type and amount:	24z		
25	Total other adjustments. Add lines 24a through 24z		25	
26	Add lines 11 through 23 and 25. These are your **adjustments to income**. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 10		26	6,500

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Form **1040** Department of the Treasury—Internal Revenue Service **U.S. Individual Income Tax Return** **2023** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2023, or other tax year beginning _____, 2023, ending _____, 20____ See separate instructions.

Your first name and middle initial	Last name	Your social security number
Tracy M.	Kidwell	433 33 3333
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. 600 S. Maestri Place — Apt. no.

City, town, or post office. If you have a foreign address, also complete spaces below. New Orleans — State LA — ZIP code 70130

Foreign country name — Foreign province/state/county — Foreign postal code

Presidential Election Campaign Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

Filing Status Check only one box.
☑ Single ☐ Head of household (HOH)
☐ Married filing jointly (even if only one had income)
☐ Married filing separately (MFS) ☐ Qualifying surviving spouse (QSS)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent: _____

Digital Assets At any time during 2023, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) ☐ Yes ☑ No

Standard Deduction **Someone can claim:** ☑ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1959 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1959 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here ☐

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) Check the box if qualifies for (see instructions): Child tax credit	Credit for other dependents
			☐	☐
			☐	☐
			☐	☐
			☐	☐

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a Form W-2, see instructions.

1a	Total amount from Form(s) W-2, box 1 (see instructions)				1a	
b	Household employee wages not reported on Form(s) W-2				1b	
c	Tip income not reported on line 1a (see instructions)				1c	
d	Medicaid waiver payments not reported on Form(s) W-2 (see instructions)				1d	
e	Taxable dependent care benefits from Form 2441, line 26				1e	
f	Employer-provided adoption benefits from Form 8839, line 29				1f	
g	Wages from Form 8919, line 6				1g	
h	Other earned income (see instructions)				1h	
i	Nontaxable combat pay election (see instructions)	1i				
z	Add lines 1a through 1h				1z	
2a	Tax-exempt interest	2a		b Taxable interest	2b	9,000
3a	Qualified dividends	3a		b Ordinary dividends	3b	
4a	IRA distributions	4a		b Taxable amount	4b	
5a	Pensions and annuities	5a		b Taxable amount	5b	
6a	Social security benefits	6a		b Taxable amount	6b	
c	If you elect to use the lump-sum election method, check here (see instructions) ☐					
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ☐				7	
8	Additional income from Schedule 1, line 10				8	
9	Add lines 1z, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income**				9	9,000
10	Adjustments to income from Schedule 1, line 26				10	
11	Subtract line 10 from line 9. This is your **adjusted gross income**				11	9,000
12	**Standard deduction or itemized deductions** (from Schedule A)				12	1,250*
13	Qualified business income deduction from Form 8995 or Form 8995-A				13	
14	Add lines 12 and 13				14	1,250
15	Subtract line 14 from line 11. If zero or less, enter -0-. This is your **taxable income**				15	7,750

Attach Sch. B if required.

Standard Deduction for—
- Single or Married filing separately, $13,850
- Married filing jointly or Qualifying surviving spouse, $27,700
- Head of household, $20,800
- If you checked any box under *Standard Deduction*, see instructions.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2023)

* For 2023, a dependent's standard deduction is limited to the greater of (1) earned income plus $400 or (2) $1,250.

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Form 1040 (2023) Page **2**

Tax and Credits	16	**Tax** (see instructions). Check if any from Form(s): **1** ☐ 8814 **2** ☐ 4972 **3** ☐		16	1,556*
	17	Amount from Schedule 2, line 3		17	
	18	Add lines 16 and 17		18	1,556
	19	Child tax credit or credit for other dependents from Schedule 8812		19	
	20	Amount from Schedule 3, line 8		20	
	21	Add lines 19 and 20		21	
	22	Subtract line 21 from line 18. If zero or less, enter -0-		22	1,556
	23	Other taxes, including self-employment tax, from Schedule 2, line 21		23	
	24	Add lines 22 and 23. This is your **total tax**		24	1,556
Payments	25	Federal income tax withheld from:			
	a	Form(s) W-2	25a		
	b	Form(s) 1099	25b		
	c	Other forms (see instructions)	25c		
	d	Add lines 25a through 25c		25d	
If you have a qualifying child, attach Sch. EIC.	26	2023 estimated tax payments and amount applied from 2022 return		26	
	27	Earned income credit (EIC)	27		
	28	Additional child tax credit from Schedule 8812	28		
	29	American opportunity credit from Form 8863, line 8	29		
	30	Reserved for future use	30		
	31	Amount from Schedule 3, line 15	31		
	32	Add lines 27, 28, 29, and 31. These are your **total other payments and refundable credits**		32	
	33	Add lines 25d, 26, and 32. These are your **total payments**		33	-0-
Refund	34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**		34	
	35a	Amount of line 34 you want **refunded to you**. If Form 8888 is attached, check here ☐		35a	
Direct deposit? See instructions.	b	Routing number **c** Type: ☐ Checking ☐ Savings			
	d	Account number			
	36	Amount of line 34 you want **applied to your 2024 estimated tax**	36		
Amount You Owe	37	Subtract line 33 from line 24. This is the **amount you owe**. For details on how to pay, go to *www.irs.gov/Payments* or see instructions		37	1,556
	38	Estimated tax penalty (see instructions)	38		

Third Party Designee

Do you want to allow another person to discuss this return with the IRS? See instructions ☐ **Yes.** Complete below. ☑ **No** * *

Designee's name | Phone no. | Personal identification number (PIN)

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Student	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)
Phone no.	Email address		

Joint return? See instructions. Keep a copy for your records.

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name				Phone no.
Firm's address				Firm's EIN

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2023)

* From Line 18 of Form 8615.

** This information is not included in the problem's facts, but it is included here for completeness. Instructors may want to provide this information to students when assigning this problem.

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Form **8615**

Department of the Treasury
Internal Revenue Service

Tax for Certain Children Who Have Unearned Income

Attach only to the child's Form 1040 or 1040-NR.
Go to *www.irs.gov/Form8615* for instructions and the latest information.

OMB No. 1545-0074

2023

Attachment Sequence No. **33**

Child's name shown on return	Child's social security number
Tracy M. Kidwell	433 33 3333

A Parent's name (first, initial, and last). **Caution:** See instructions before completing.	**B** Parent's social security number
Kelly S. Kidwell	433 33 1111

C Parent's filing status (check one):
☐ Single ☑ Married filing jointly ☐ Married filing separately ☐ Head of household ☐ Qualifying surviving spouse

Part I Child's Net Unearned Income

1	Enter the child's unearned income. See instructions	1	9,000
2	If the child **did not** itemize deductions on **Schedule A** (Form 1040) or **Schedule A** (Form 1040-NR), enter $2,500. Otherwise, see instructions	2	2,500
3	Subtract line 2 from line 1. If zero or less, **stop**; do not complete the rest of this form but **do** attach it to the child's return	3	6,500
4	Enter the child's **taxable income** from Form 1040 or 1040-NR, line 15. If the child files Form 2555, see the instructions	4	7,750
5	Enter the **smaller** of line 3 or line 4. If zero, **stop**; do not complete the rest of this form but **do** attach it to the child's return	5	6,500

Part II Tentative Tax Based on the Tax Rate of the Parent

6	Enter the parent's **taxable income** from Form 1040 or 1040-NR, line 15. If zero or less, enter -0-. If the parent files Form 2555, see the instructions	6	132,000
7	Enter the total, if any, from Forms 8615, line 5, of **all other** children of the parent named above. **Do not** include the amount from line 5 above	7	
8	Add lines 5, 6, and 7. See instructions	8	138,500
9	Enter the tax on the amount on line 8 based on the **parent's** filing status above. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ☐	9	21,085[a]
10	Enter the parent's tax from Form 1040 or 1040-NR, line 16, minus any alternative minimum tax. **Do not** include any tax from **Form 4972** or **Form 8814**, or any tax from the recapture of an education credit. If the parent files Form 2555, see the instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) was used to figure the tax, check here ☐	10	19,655[b]
11	Subtract line 10 from line 9 and enter the result. If line 7 is blank, also enter this amount on line 13 and go to **Part III**	11	1,430
12a	Add lines 5 and 7 — 12a: 6,500		
b	Divide line 5 by line 12a. Enter the result as a decimal (rounded to at least three places)	12b	× 1.000
13	Multiply line 11 by line 12b	13	1,430

Part III Child's Tax—If lines 4 and 5 above are the same, enter -0- on line 15 and go to line 16.

14	Subtract line 5 from line 4	14	1,250	
15	Enter the tax on the amount on line 14 based on the **child's** filing status. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ☐			15 126[c]
16	Add lines 13 and 15			16 1,556
17	Enter the tax on the amount on line 4 based on the **child's** filing status. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ☐			17 778[d]
18	Enter the **larger** of line 16 or line 17 here and on the **child's** Form 1040 or 1040-NR, line 16. If the child files Form 2555, see the instructions			18 1,556

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 64113U Form **8615** (2023)

[a] $10,294.00 + .22 ($138,500 - $89,450)
[b] $10,294.00 + .22 ($132,000 - $89,450)
[c] From 2023 Tax Table. The amount on Line 15 would be $125 ($1,250 × 0.10) if the tax rate schedule were used instead.
[d] From 2023 Tax Table. The amount on Line 17 would be $775 ($7,750 × 0.10) if the tax rate schedule were used instead.

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