Income Tax Fundamentals 2018 36th edition Whittenburg Solutions Manual

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CHAPTER 2

GROSS INCOME AND EXCLUSIONS

Group 1 – Multiple Choice Questions

1. C (LO 2.1)
2. C (LO 2.1)
3. A (LO 2.1)
4. D (LO 2.1)
5. B (LO 2.1)
6. C $500 x 20% (LO 2.2)
7. A (LO 2.2)
8. C $120 x 12 (LO 2.3)
9. D (LO 2.3)
10. E (LO 2.4)
11. D (LO 2.4)
12. B $97,500/260 = $375 x 4 = $1,500 (LO 2.5)
13. D (LO 2.5)
14. C (LO 2.6)
15. A (LO 2.6)
16. C (LO 2.7)
17. D (LO 2.7, 2.8, 2.9, 2.10)
18. C (LO 2.8)
19. A (LO 2.9)
20. E (LO 2.10)
21. D (LO 2.11)
22. E (LO 2.12)
23. D (LO 2.13)
24. E (LO 2.13)
25. A (LO 2.14)
26. E (LO 2.14)

Group 2 – Problems

1. a. Excluded (LO 2.1)
   b. Included (LO 2.1)
   c. Included (LO 2.1)
   d. Included (LO 2.1)
   e. Excluded (LO 2.1)
   f. Included (LO 2.1)
   g. Included (LO 2.1)
   h. Excluded (LO 2.1)
   i. Excluded (LO 2.1)
   j. Excluded (LO 2.1)
   k. Included (LO 2.1)

2. The non-cash payment of $6,000 for services performed is includable income to John. The tax law states that gross income is "all income from whatever source derived." There is no exception in the law for non-cash items received in exchange for services. (LO 2.1)

3. a. **$300**. Gross income includes "all income from whatever source derived." The value of the hair styling is income to Larry for the performance of services. There is no gross income exception in the tax law for "barter" income.
   b. **$300**. Gross income includes "all income from whatever source derived." The value of the tax return is income to Sheila for the performance of services. There is no gross income exception in the tax law for "barter" income. (LO 2.1)

4. Illegal income is still taxable since there is no exception excluding it in the tax code. When there is not an explicit exception, gross income is "all income from whatever source derived." (LO 2.1)

5. Qualified dividends are taxed at either 0%, 15%, or 20%. The 0% rate applies for taxpayers in the ordinary income tax brackets of 10% and 15%. The 15% rate applies for taxpayers in the ordinary income tax brackets of 25% through 35%. The 20% rate applies for taxpayers in the 39.6% bracket. A 3.8% Medicare tax on net investment income will be added to the rates for certain high-income taxpayers. (LO 2.2)

6. If no election is made, the interest is not included in income until the I bond is converted to cash by the taxpayer. If the taxpayer makes an election, however, the income which increases the redemption value but is not paid in cash on the I bond each year is included in the taxpayer's gross income. (LO 2.2)

7. See Schedule B on Page 40. (LO 2.2)

8. a. (1) **$450**.
      (2) **$450**.
   b. (1) **$0**.
      (2) **$425,000**. (LO 2.3)

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9. Arlen may deduct the alimony of $2,000 per month on his tax return. He cannot deduct the child support. Jane must report the alimony as income on her tax return. The child support is not taxable income to her. (LO 2.3)

10. No gain is taxable to Cindy on the transfer of the house since it is part of a property settlement related to a divorce. Allen has a basis of $90,000 in the house for calculating tax on any future sale of the house. (LO 2.3)

11. a. **$6,400**.
    b. **$260**. A non-qualified plan award may only be excluded up to $400; thus, $260 is taxable.
    c. **$1,000,000**.
    d. **$30,000**. (LO 2.4)

12. a. **$4,000**.
    b. **$14,500**.
    c. **$0**. (LO 2.4, 2.8)

13. SIMPLIFIED METHOD WORKSHEET

1)	Enter total amount received this year.		1) $ 7,000
2)	Enter cost in the plan at the annuity starting date.		2) $48,300
3)	Age at annuity starting date	*Enter*	
	55 and under	360	
	56–60	310	
	61–65	260	3) 210
	66–70	210	
	71 and older	160	
4)	Divide line 2 by line 3.		4) $ 230
5)	Multiply line 4 by the number of monthly payments this year. If the annuity starting date was before 1987, also enter this amount on line 8; and skip lines 6 and 7. Otherwise go to line 6.		5) $ 1,610
6)	Enter the amount, if any, recovered tax free in prior years		6) $ 0
7)	Subtract line 6 from line 2.		7) $48,300
8)	Enter the smaller of line 5 or 7.		8) $ 1,610
9)	Taxable amount this year: Subtract line 8 from line 1. Do not enter less than zero.		9) $ 5,390

(LO 2.5)

14. **$61,000** = $100,000 – $27,000 – $12,000. Since the policy was transferred for valuable consideration, the proceeds are taxable to the extent that they exceed the sum of the cash value at the time of transfer plus the premiums paid. (LO 2.6)

15. **$500**. A beneficiary, who is a surviving spouse, must include the entire amount of interest received with respect to the policy proceeds in gross income. The $9,000 principal amount may be excluded from gross income. (LO 2.6)

16. David has received an accelerated death benefit or viatical settlement which is excluded from taxable income. (LO 2.6)

17. None of the payment is taxable. Life insurance proceeds are generally considered to be tax-free and specifically excluded from taxable income. (LO 2.6)

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18. **$5,600**. Inheritances are excluded from taxable income; however, subsequent earnings on inherited property must be included in income. (LO 2.7)

19. $10,000 is taxable. This gift is clearly bonus income in a business setting so it does not qualify for tax-free gift treatment, even if Gwen's client calls the payment a gift. (LO 2.7)

20. None of the gift is taxable. Gifts are excluded from the taxable income of the person receiving the gift. (LO 2.7)

21. $12,000 is taxable since there is no exclusion for payments made for room and board. $8,000 is not taxable, since scholarships for tuition are specifically excluded from taxable income. (LO 2.8)

22. None of the cost of the insurance or amounts paid by the insurance company for surgery or treatment are taxable to Skyler. These amounts are specifically excluded from taxable income under the tax law. (LO 2.9)

23. **$0**. Taxpayers may exclude the total amount received for payment or reimbursement of medical expenses. Premiums for health insurance paid by the taxpayer's employer are also excluded from the taxpayer's gross income. In addition, the $1,500 ($3,500 – $2,000) not paid by the insurance company is deductible as an itemized deduction on Ellen's return, subject to the medical expense deduction limitations. (LO 2.9)

24. a. No. The meals are furnished by the employer on the business premises of the employer during working hours because the employer limits the employee to short meal periods.
    b. No. The meals are furnished by the employer on the business premises of the employer during working hours because the taxpayer must be available for emergency calls.
    c. Yes. The meals are not furnished for the convenience of the employer. (LO 2.10)

25. **6.00%** = 4.5% ÷ (100% – 25%). (LO 2.11)

26. The tax-exempt municipal bond has the same 5% before and after-tax rate of return. The corporate bond has an after-tax return of 4.55% (7% x (1 – 35%)). Karen should invest in the tax-exempt bond due to the higher after-tax rate of return. (LO 2.11)

27. **$3,250**. Unemployment benefits received are included in gross income. (LO 2.12)

28. **$4,850** = $850 + $4,000. The value of the airline tickets is excluded from gross income under the no additional cost services rule for employees and their families. The $30 of personal typing is excluded under the de minimis fringe benefits rule. The $850 worth of employee discount coupons for hotel rooms is included in gross income since the hotel division is a different line of business than that in which Linda is employed. The $4,000 tuition payment must be included in gross income since Richard is working on a graduate degree and not providing teaching or research activities. (LO 2.13)

29. Yes. Tom will be better off reducing his taxable income by $2,600 by using the health care flexible spending account. Since his income will be $2,600 less, he will pay less tax than he would otherwise. (LO 2.13)

30. As calculated on the worksheet on Page 41. (LO 2.14)

31. a. **Yes**. Tax-free municipal bond income is added to AGI in the formula to determine the amount of taxable Social Security.
    b. **Zero**. The taxpayer's income is below the threshold amount used in the formula to determine whether Social Security is taxable.
    c. **85%**. High-income taxpayers must include 85% of Social Security receipts in taxable income. (LO 2.14)

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Group 2: Problem 7

SCHEDULE B (Form 1040A or 1040)

Department of the Treasury
Internal Revenue Service (99)

Interest and Ordinary Dividends

▶ Attach to Form 1040A or 1040.
▶ Go to *www.irs.gov/ScheduleB* for instructions and the latest information.

OMB No. 1545-0074

2017

Attachment Sequence No. 08

Name(s) shown on return: Charles and Sally Heck

Your social security number:

DRAFT AS OF July 10, 2017 DO NOT FILE

Part I Interest

(See instructions and the instructions for Form 1040A, or Form 1040, line 8a.)

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

			Amount
1	List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address ▶		
	Porcine Bank		1,245
	River Bank		650
	[note: municipal tax-exempt interest is reported directly on the Form 1040 or 1040-A]		
		1	
2	Add the amounts on line 1	2	1,895
3	Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815	3	
4	Subtract line 3 from line 2. Enter the result here and on Form 1040A, or Form 1040, line 8a ▶	4	1,895

Note: If line 4 is over $1,500, you must complete Part III.

Part II Ordinary Dividends

(See instructions and the instructions for Form 1040A, or Form 1040, line 9a.)

Note: If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

			Amount
5	List name of payer ▶		
	Altus, Inc.		2,000
	Buller Corporation		350
	Gene Corporation		3,100
	Devona Corporation		850
		5	
6	Add the amounts on line 5. Enter the total here and on Form 1040A, or Form 1040, line 9a ▶	6	6,300

Note: If line 6 is over $1,500, you must complete Part III.

Part III Foreign Accounts and Trusts

(See instructions.)

		Yes	No
	You must complete this part if you **(a)** had over $1,500 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.		
7a	At any time during 2017, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		X
	If "Yes," are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
b	If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ▶		
8	During 2017, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions		X

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Group 2: Problem 30

1.	Enter the total amount of social security income	**1.**	$7,400
2.	Enter one-half of line 1	**2.**	3,700
3.	Enter the total of taxable income items on Form 1040 except social security income	**3.**	14,500
4.	Enter the amount of tax exempt interest income	**4.**	30,000
5.	Add lines 2, 3, and 4	**5.**	48,200
6.	Enter all adjustments for AGI except for student loan interest, the domestic production activities deduction and the tuition and fees deduction	**6.**	-0-
7.	Subtract line 6 from line 5. If zero or less, stop here, none of the social security benefits are taxable	**7.**	48,200
8.	Enter $25,000 ($32,000 if married filing jointly; $0 if married filing separately and living with spouse at any time during the year)	**8.**	25,000
9.	Subtract line 8 from line 7. If zero or less, enter -0-	**9.**	23,200
Note:	*If line 9 is zero or less, stop here;* **none of your benefits are taxable**. *Otherwise, go on to line 10.*		
10.	Enter $9,000 ($12,000 if married filing jointly; $0 if married filing separately and living with spouse at any time during the year)	**10.**	9,000
11.	Subtract line 10 from line 9. If zero or less, enter -0-	**11.**	14,200
12.	Enter the **smaller** of line 9 or line 10	**12.**	9,000
13.	Enter one-half of line 12	**13.**	4,500
14.	Enter the **smaller** of line 2 or line 13	**14.**	3,700
15.	Multiply line 11 by 85% (.85). If line 11 is zero, enter -0-	**15.**	12,070
16.	Add lines 14 and 15	**16.**	15,770
17.	Multiply line 1 by 85% (.85)	**17.**	6,290
18.	**Taxable benefits**. Enter the **smaller** of line 16 or line 17	**18.**	$6,290

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32. Worksheet 1. **Recapture of Alimony** *Keep for Your Records*

Note. ***Do not enter less than -0- on any line.***

1.	Alimony paid in **2nd year**		1. $60,000	
2.	Alimony paid in **3rd year**	2. $10,000		
3.	Floor	3. $15,000		
4.	Add lines 2 and 3		4. $25,000	
5.	Subtract line 4 from line 1. If zero or less, enter -0-			5. $35,000
6.	Alimony paid in **1st year**		6. $60,000	
7.	Adjusted alimony paid in **2nd year** (line 1 minus line 5)	7. $25,000		
8.	Alimony paid in **3rd year**	8. $10,000		
9.	Add lines 7 and 8	9. $35,000		
10.	Divide line 9 by 2	10. $17,500		
11.	Floor	11. $15,000		
12.	Add lines 10 and 11		12. $32,500	
13.	Subtract line 12 from line 6			13. $27,500
14.	**Recaptured alimony**. Add lines 5 and 13			*14. $62,500

* If you deducted alimony paid, report this amount as income on Form 1040, line 11.
If you reported alimony received, deduct this amount on Form 1040, line 31a.

33. See the answer to Problem 7.

Group 3 – Writing Assignment

Research Solution:

Whittenburg and Gill, CPAs
San Diego, CA
August 3, 20xx

Ms. Vanessa Lazo
1550 Mesa Rosa Drive
San Diego, CA

Dear Professor Lazo,

Thank you for requesting my advice concerning the tax treatment of your free trip to Costa Rica. I have researched your question and am sorry to say that the free tour is taxable.

The fair market value of the tour must be reported on Form 1040, Line 21 "Other Income." In addition, any expenses that you incurred during the trip cannot be deducted.

My conclusion is based upon the facts that you have provided me. I'm sorry that the news was not more favorable. If you have any questions or would like further explanation, please do not hesitate to call.

Sincerely,
Trevor Malcolm
for Whittenburg and Gill, CPAs

Group 4 – Comprehensive Problems

1. See pages 43 through 45.

2A. See pages 46 through 47.

2B. See pages 48 through 49.

Group 5 – Cumulative Software Problem

The solution to the Cumulative Software Problem is posted on the website for the textbook at *www.cengage.com/login*.

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Comprehensive Problem 1

Form **1040A** — Department of the Treasury—Internal Revenue Service — **U.S. Individual Income Tax Return** (99) — **2017** — IRS Use Only—Do not write or staple in this space.

OMB No. 1545-0074

Your first name and initial	Ken
Last name	Hair
Your social security number	465 57 9934
If a joint return, spouse's first name and initial	Bev
Last name	Hair
Spouse's social security number	465 74 3321
Home address (number and street). If you have a P.O. box, see instructions.	3567 River Street
Apt. no.	
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).	Springfield, MO 63126
Foreign country name	
Foreign province/state/county	
Foreign postal code	

▲ Make sure the SSN(s) above and on line 6c are correct.

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. [X] You [X] Spouse

August 11, 2019 DO NOT FILE

Filing status Check only one box.

1 [ ] Single
2 [X] Married filing jointly (even if only one had income)
3 [ ] Married filing separately. Enter spouse's SSN above and full name here. ▶
4 [ ] Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 [ ] Qualifying widow(er) (see instructions)

Exemptions

6a [X] **Yourself.** If someone can claim you as a dependent, **do not** check box 6a.
b [X] **Spouse**
c **Dependents:**

If more than six dependents, see instructions.

(1) First name / Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			[ ]
			[ ]
			[ ]
			[ ]
			[ ]
			[ ]

Boxes checked on 6a and 6b: 2
No. of children on 6c who:
• lived with you:
• did not live with you due to divorce or separation (see instructions):
Dependents on 6c not entered above:
Add numbers on lines above ▶: 2

d Total number of exemptions claimed.

Income

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

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

7	Wages, salaries, tips, etc. Attach Form(s) W-2.			7	53,120
8a	**Taxable** interest. Attach Schedule B if required.			8a	645
b	**Tax-exempt** interest. **Do not** include on line 8a.	8b	1,000		
9a	Ordinary dividends. Attach Schedule B if required.			9a	302
b	Qualified dividends (see instructions).	9b	302		
10	Capital gain distributions (see instructions).			10	
11a	IRA distributions.	11a		11b Taxable amount (see instructions). 11b	
12a	Pensions and annuities.	12a		12b Taxable amount (see instructions). 12b	
13	Unemployment compensation and Alaska Permanent Fund dividends.			13	1,825
14a	Social security benefits.	14a		14b Taxable amount (see instructions). 14b	
15	Add lines 7 through 14b (far right column). This is your **total income.** ▶			15	55,892

Adjusted gross income

16	Educator expenses (see instructions).	16	
17	IRA deduction (see instructions).	17	
18	Student loan interest deduction (see instructions).	18	
19	Reserved for future use.	19	
20	Add lines 16 through 19. These are your **total adjustments.**	20	
21	Subtract line 20 from line 15. This is your **adjusted gross income.** ▶	21	55,892

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11327A Form **1040A** (2017)

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Comprehensive Problem 1, cont.

Form 1040A (2017) Page **2**

Tax, credits, and payments	**22**	Enter the amount from line 21 (adjusted gross income).		22	55,892
	23a	Check if: ☐ **You** were born before January 2, 1953, ☐ Blind ☐ **Spouse** was born before January 2, 1953, ☐ Blind } **Total boxes checked** ▶ 23a			
	b	If you are married filing separately and your spouse itemizes deductions, check here ▶ 23b ☐			
Standard Deduction for— • People who check any box on line 23a or 23b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,350 Married filing jointly or Qualifying widow(er), $12,700 Head of household, $9,350	**24**	Enter your **standard deduction**.		24	12,700
	25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.		25	43,192
	26	**Exemptions.** Multiply $4,050 by the number on line 6d.		26	8,100
	27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your **taxable income.** ▶		27	35,092
	28	**Tax,** including any alternative minimum tax (see instructions).	28 4,284		
	29	Excess advance premium tax credit repayment. Attach Form 8962.	29		
	30	Add lines 28 and 29.		30	4,284
	31	Credit for child and dependent care expenses. Attach Form 2441.	31		
	32	Credit for the elderly or the disabled. Attach Schedule R.	32		
	33	Education credits from Form 8863, line 19.	33		
	34	Retirement savings contributions credit. Attach Form 8880.	34		
	35	Child tax credit. Attach Schedule 8812, if required.	35		
	36	Add lines 31 through 35. These are your **total credits.**		36	
	37	Subtract line 36 from line 30. If line 36 is more than line 30, enter -0-.		37	4,284
	38	Health care: individual responsibility (see instructions). Full-year coverage ☒		38	
	39	Add line 37 and line 38. This is your **total tax.**		39	4,284
	40	Federal income tax withheld from Forms W-2 and 1099.	40 5,005		
If you have a qualifying child, attach Schedule EIC.	**41**	2017 estimated tax payments and amount applied from 2016 return.	41		
	42a	**Earned income credit (EIC).**	42a		
	b	Nontaxable combat pay election. 42b			
	43	Additional child tax credit. Attach Schedule 8812.	43		
	44	American opportunity credit from Form 8863, line 8.	44		
	45	Net premium tax credit. Attach Form 8962.	45		
	46	Add lines 40, 41, 42a, 43, 44, and 45. These are your **total payments.** ▶		46	5,005
Refund	**47**	If line 46 is more than line 39, subtract line 39 from line 46. This is the amount you **overpaid.**		47	721
Direct deposit? See instructions and fill in 48b, 48c, and 48d or Form 8888.	**48a**	Amount of line 47 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		48a	721
	▶ **b**	Routing number ☐☐☐☐☐☐☐☐☐ ▶ **c** Type: ☐ Checking ☐ Savings			
	▶ **d**	Account number ☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐			
	49	Amount of line 47 you want **applied to your 2018 estimated tax.**	49		
Amount you owe	**50**	**Amount you owe.** Subtract line 46 from line 39. For details on how to pay, see instructions. ▶		50	
	51	Estimated tax penalty (see instructions).	51		

Third party designee

Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ **Yes.** Complete the following. ☐ **No**

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

Sign here

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

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 accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number
		Student	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.) ☐☐☐☐☐☐
		Accountant	

Paid preparer use only

Print/Type preparer's name	Preparer's signature	Date	Check ▶ ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

Go to *www.irs.gov/Form1040A* for instructions and the latest information. Form **1040A** (2017)

DRAFT AS OF August 11, 2017 DO NOT FILE

Comprehensive Problem 1, cont.

Qualified Dividends and Capital Gain Tax Worksheet—Line 28 *Keep for Your Records* *

Before you begin: ✓ Be sure you do not have to file Form 1040 (see the Instructions for Form 1040A, line 10).

1. Enter the amount from Form 1040A, line 27			1.	35,092
2. Enter the amount from Form 1040A, line 9b	2.	302		
3. Enter the amount from Form 1040A, line 10	3.	0		
4. Add lines 2 and 3			4.	302
5. Subtract line 4 from line 1. If zero or less, enter -0-			5.	34,790
6. Enter the **smaller** of: • The amount on line 1, or • $37,950 if single or married filing separately, $75,900 if married filing jointly or qualifying widow(er), or $50,800 if head of household.			6.	35,092
7. Enter the smaller of line 5 or line 6			7.	34,790
8. Subtract line 7 from line 6. This amount is taxed at 0%			8.	302
9. Enter the smaller of line 1 or line 4			9.	302
10. Enter the amount from line 8			10.	302
11. Subtract line 10 from line 9			11.	0
12. Multiply line 11 by 15% (0.15)			12.	0
13. Use the Tax Table to figure the tax on the amount on line 5. Enter the tax here			13.	4,284
14. Add lines 12 and 13			14.	4,284
15. Use the Tax Table to figure the tax on the amount on line 1. Enter the tax here			15.	4,329
16. Tax on all taxable income. Enter the **smaller** of line 14 or line 15 here and on Form 1040A, line 28			16.	4,284

* Note: This worksheet does not apply for high-income taxpayers under the ACA or ATRA provisions (See LO 1.9).

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Comprehensive Problem 2A

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** 2017 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2017, or other tax year beginning , 2017, ending , 20 — See separate instructions.

Your first name and initial	Last name	Your social security number
Ray	Gomez	469 | 21 | 5523
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Maria	Gomez	444 | 65 | 9912

Home address (number and street). If you have a P.O. box, see instructions. — Apt. no.: 1610 Quince Avenue

▲ Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).: McAllen, TX 78701

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. [X] You [X] Spouse

August 15, 2018 DO NOT FILE

Filing Status Check only one box.

1 [ ] Single
2 [X] Married filing jointly (even if only one had income)
3 [ ] Married filing separately. Enter spouse's SSN above and full name here. ▶
4 [ ] Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 [ ] Qualifying widow(er) (see instructions)

Exemptions

6a [X] **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b [X] **Spouse**

Boxes checked on 6a and 6b: 2

c **Dependents:** (1) First name / Last name | (2) Dependent's social security number | (3) Dependent's relationship to you | (4) ✓ if child under age 17 qualifying for child tax credit (see instructions)

If more than four dependents, see instructions and check here ▶ [ ]

No. of children on 6c who: • lived with you • did not live with you due to divorce or separation (see instructions)

Dependents on 6c not entered above

d Total number of exemptions claimed — Add numbers on lines above ▶: 2

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 W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7	62,501
8a	**Taxable** interest. Attach Schedule B if required		8a	652
b	**Tax-exempt** interest. **Do not** include on line 8a	8b		
9a	Ordinary dividends. Attach Schedule B if required		9a	
b	Qualified dividends	9b		
10	Taxable refunds, credits, or offsets of state and local income taxes		10	
11	Alimony received		11	
12	Business income or (loss). Attach Schedule C or C-EZ		12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ [ ]		13	
14	Other gains or (losses). Attach Form 4797		14	
15a	IRA distributions 15a	b Taxable amount	15b	
16a	Pensions and annuities 16a	b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17	
18	Farm income or (loss). Attach Schedule F		18	
19	Unemployment compensation		19	
20a	Social security benefits 20a	b Taxable amount	20b	
21	Other income. List type and amount: Lottery winnings		21	3,800
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	66,953

Adjusted Gross Income

23	Educator expenses	23		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25	Health savings account deduction. Attach Form 8889	25		
26	Moving expenses. Attach Form 3903	26		
27	Deductible part of self-employment tax. Attach Schedule SE	27		
28	Self-employed SEP, SIMPLE, and qualified plans	28		
29	Self-employed health insurance deduction	29		
30	Penalty on early withdrawal of savings	30		
31a	Alimony paid b Recipient's SSN ▶ 566 | 74 | 8765	31a	5,400	
32	IRA deduction	32		
33	Student loan interest deduction	33		
34	Reserved for future use	34		
35	Domestic production activities deduction. Attach Form 8903	35		
36	Add lines 23 through 35		36	5,400
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37	61,553

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Comprehensive Problem 2A, cont.

Form 1040 (2017) Page 2

	38	Amount from line 37 (adjusted gross income)		38	61,553
Tax and Credits	39a	Check if: ☐ **You** were born before January 2, 1953, ☐ Blind. ☐ **Spouse** was born before January 2, 1953, ☐ Blind. **Total boxes checked** ▶ 39a			
	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b ☐			
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,350 Married filing jointly or Qualifying widow(er), $12,700 Head of household, $9,350	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40	12,700
	41	Subtract line 40 from line 38		41	48,853
	42	**Exemptions.** If line 38 is $156,900 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions		42	8,100
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	40,753
	44	**Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐		44	5,184
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
	46	Excess advance premium tax credit repayment. Attach Form 8962		46	
	47	Add lines 44, 45, and 46 ▶		47	5,184
	48	Foreign tax credit. Attach Form 1116 if required	48		
	49	Credit for child and dependent care expenses. Attach Form 2441	49		
	50	Education credits from Form 8863, line 19	50		
	51	Retirement savings contributions credit. Attach Form 8880	51		
	52	Child tax credit. Attach Schedule 8812, if required	52		
	53	Residential energy credit. Attach Form 5695	53		
	54	Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐	54		
	55	Add lines 48 through 54. These are your **total credits**		55	
	56	Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- ▶		56	5,184
Other Taxes	57	Self-employment tax. Attach Schedule SE		57	
	58	Unreported social security and Medicare tax from Form: **a** ☐ 4137 **b** ☐ 8919		58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		59	
	60a	Household employment taxes from Schedule H		60a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		60b	
	61	Health care: individual responsibility (see instructions) Full-year coverage ☒		61	
	62	Taxes from: **a** ☐ Form 8959 **b** ☐ Form 8960 **c** ☐ Instructions; enter code(s)		62	
	63	Add lines 56 through 62. This is your **total tax** ▶		63	5,184
Payments	64	Federal income tax withheld from Forms W-2 and 1099	64 9,050		
If you have a qualifying child, attach Schedule EIC.	65	2017 estimated tax payments and amount applied from 2016 return	65		
	66a	**Earned income credit (EIC)**	66a		
	b	Nontaxable combat pay election 66b			
	67	Additional child tax credit. Attach Schedule 8812	67		
	68	American opportunity credit from Form 8863, line 8	68		
	69	Net premium tax credit. Attach Form 8962	69		
	70	Amount paid with request for extension to file	70		
	71	Excess social security and tier 1 RRTA tax withheld	71		
	72	Credit for federal tax on fuels. Attach Form 4136	72		
	73	Credits from Form: **a** ☐ 2439 **b** ☐ Reserved **c** ☐ 8885 **d** ☐	73		
	74	Add lines 64, 65, 66a, and 67 through 73. These are your **total payments** ▶		74	9,050
Refund	75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**		75	3,866
	76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		76a	3,866
Direct deposit? See instructions.	▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings			
	▶ d	Account number			
	77	Amount of line 75 you want **applied to your 2018 estimated tax** ▶	77		
Amount You Owe	78	**Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶		78	
	79	Estimated tax penalty (see instructions)	79		

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 accurately list all amounts and sources of income I received during the tax year. 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	Daytime phone number
		Salesperson	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Clerk	

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2017)

DRAFT AS OF August 15, 2018 DO NOT FILE

Comprehensive Problem 2B

Form 1040 Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** 2017 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2017, or other tax year beginning , 2017, ending , 20 — See separate instructions.

Your first name and initial	Last name	Your social security number
Carl	Conch	835 | 21 | 5423
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Mary	Duval	633 | 65 | 7912

Home address (number and street). If you have a P.O. box, see instructions. 1234 Mallory Square — Apt. no. 64

Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). Key West, FL 33040

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. [X] You [X] Spouse

August 15, 2017 DO NOT FILE

Filing Status Check only one box.
1 [ ] Single
2 [X] Married filing jointly (even if only one had income)
3 [ ] Married filing separately. Enter spouse's SSN above and full name here. ▶
4 [ ] Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 [ ] Qualifying widow(er) (see instructions)

Exemptions
6a [X] **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b [X] **Spouse**
Boxes checked on 6a and 6b: 2

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			[ ]
			[ ]
			[ ]
			[ ]

If more than four dependents, see instructions and check here ▶ [ ]

No. of children on 6c who: • lived with you • did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above
d Total number of exemptions claimed — Add numbers on lines above ▶ 2

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 W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	67,680
8a	**Taxable** interest. Attach Schedule B if required	8a	355
b	**Tax-exempt** interest. **Do not** include on line 8a (8b)		
9a	Ordinary dividends. Attach Schedule B if required	9a	212
b	Qualified dividends (9b) 0		
10	Taxable refunds, credits, or offsets of state and local income taxes	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ [ ]	13	
14	Other gains or (losses). Attach Form 4797	14	
15a	IRA distributions (15a) — b Taxable amount	15b	
16a	Pensions and annuities (16a) — b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	
18	Farm income or (loss). Attach Schedule F	18	
19	Unemployment compensation	19	2,756
20a	Social security benefits (20a) — b Taxable amount	20b	
21	Other income. List type and amount: Raffle prize	21	750
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶	22	71,753

Adjusted Gross Income

23	Educator expenses (23)		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ (24)		
25	Health savings account deduction. Attach Form 8889 (25)		
26	Moving expenses. Attach Form 3903 (26)		
27	Deductible part of self-employment tax. Attach Schedule SE (27)		
28	Self-employed SEP, SIMPLE, and qualified plans (28)		
29	Self-employed health insurance deduction (29)		
30	Penalty on early withdrawal of savings (30)		
31a	Alimony paid b Recipient's SSN ▶ (31a)		
32	IRA deduction (32)		
33	Student loan interest deduction (33)		
34	Reserved for future use (34)		
35	Domestic production activities deduction. Attach Form 8903 (35)		
36	Add lines 23 through 35	36	
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶	37	71,753

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Comprehensive Problem 2B, cont.

Form 1040 (2017) Page 2

Tax and Credits	38	Amount from line 37 (adjusted gross income)		38	71,753
	39a	Check if: ☐ **You** were born before January 2, 1953, ☐ Blind. ☐ **Spouse** was born before January 2, 1953, ☐ Blind. **Total boxes checked ▶ 39a**			
	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b ☐			
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,350 Married filing jointly or Qualifying widow(er), $12,700 Head of household, $9,350	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40	12,700
	41	Subtract line 40 from line 38		41	59,053
	42	**Exemptions.** If line 38 is $156,900 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions		42	8,100
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	50,953
	44	**Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐		44	6,714
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
	46	Excess advance premium tax credit repayment. Attach Form 8962		46	
	47	Add lines 44, 45, and 46 ▶		47	6,714
	48	Foreign tax credit. Attach Form 1116 if required	48		
	49	Credit for child and dependent care expenses. Attach Form 2441	49		
	50	Education credits from Form 8863, line 19	50		
	51	Retirement savings contributions credit. Attach Form 8880	51		
	52	Child tax credit. Attach Schedule 8812, if required	52		
	53	Residential energy credit. Attach Form 5695	53		
	54	Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐	54		
	55	Add lines 48 through 54. These are your **total credits**		55	
	56	Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- ▶		56	6,714
Other Taxes	57	Self-employment tax. Attach Schedule SE		57	
	58	Unreported social security and Medicare tax from Form: **a** ☐ 4137 **b** ☐ 8919		58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		59	
	60a	Household employment taxes from Schedule H		60a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		60b	
	61	Health care: individual responsibility (see instructions) Full-year coverage ☒		61	
	62	Taxes from: **a** ☐ Form 8959 **b** ☐ Form 8960 **c** ☐ Instructions; enter code(s)		62	
	63	Add lines 56 through 62. This is your **total tax** ▶		63	6,714
Payments	64	Federal income tax withheld from Forms W-2 and 1099	64 7,864		
If you have a qualifying child, attach Schedule EIC.	65	2017 estimated tax payments and amount applied from 2016 return	65		
	66a	**Earned income credit (EIC)**	66a		
	b	Nontaxable combat pay election 66b			
	67	Additional child tax credit. Attach Schedule 8812	67		
	68	American opportunity credit from Form 8863, line 8	68		
	69	Net premium tax credit. Attach Form 8962	69		
	70	Amount paid with request for extension to file	70		
	71	Excess social security and tier 1 RRTA tax withheld	71		
	72	Credit for federal tax on fuels. Attach Form 4136	72		
	73	Credits from Form: **a** ☐ 2439 **b** ☒ Reserved **c** ☐ 8885 **d** ☐	73		
	74	Add lines 64, 65, 66a, and 67 through 73. These are your **total payments** ▶		74	7,864
Refund	75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**		75	1,150
	76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		76a	1,150
Direct deposit? See instructions.	b	Routing number ▶ **c** Type: ☐ Checking ☐ Savings			
	d	Account number			
	77	Amount of line 75 you want **applied to your 2018 estimated tax** ▶	77		
Amount You Owe	78	**Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶		78	
	79	Estimated tax penalty (see instructions)	79		

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 accurately list all amounts and sources of income I received during the tax year. 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	Daytime phone number
		Pie Maker	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Homemaker	

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN

Firm's name ▶ Firm's EIN ▶

Firm's address ▶ Phone no.

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2017)

PAID AS OF August 15 DO NOT FILE

Key Number Tax Return Summary

Chapter 2

Comprehensive Problem 1

Adjusted Gross Income (Line 21)	55,892
Taxable Income (Line 27)	35,092
Total Tax (Line 39)	4,284
Amount Overpaid (Line 47)	721

Comprehensive Problem 2A

Adjusted Gross Income (Line 37)	61,553
Taxable Income (Line 43)	40,753
Total Tax (Line 63)	5,184
Amount Overpaid (Line 75)	3,866

Comprehensive Problem 2B

Adjusted Gross Income (Line 37)	71,753
Taxable Income (Line 43)	50,953
Total Tax (Line 63)	6,714
Amount Overpaid (Line 75)	1,150

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Chapter Two
Gross Income and Exclusions

Learning Objective 2.1 The Nature of Gross Income

Gross income is the initial point of tax computation and is composed of the following items:

1. Compensation for services, including fees, commissions, fringe benefits, and similar items
2. Gross income derived from business
3. Gains derived from dealings in property
4. Interest
5. Rents
6. Royalties
7. Dividends
8. Alimony and separate maintenance payments
9. Annuities
10. Income from life insurance and endowment contracts
11. Pensions
12. Income from discharge of indebtedness
13. Distributive share of partnership gross income
14. Income in respect of a decedent
15. Income from an interest in an estate or trust

The general rule is that "*all income from whatever source derived"* must be included in gross income unless specifically excluded.

- Noncash items should be reported at a fair market value.
- Specific exclusions can be found in Table 2.2.

Learning Objective 2.2 Interest and Dividend Income

Interest and dividend income is part of gross income.

- If a taxpayer earns $1,500 or more in interest and dividends, must file a Schedule B
- Interest and dividends from cooperative banks, credit unions, domestic building and loan associations, domestic savings and loan associations, federal savings and loan associations and mutual savings banks are included.

Savings bonds come in three different forms:

- Series EE, Series HH and Series I.
    - Series EE bonds are issued at a discount.
    - Series HH bonds are bonds that have interest paid semi-annually.
    - Series I bonds do not pay interest until maturity, but earnings are adjusted for inflation on a semi-annual basis.
    - *Note:* Cash basis taxpayers report the increase in redemption value on a Series EE or Series I bonds

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- Dividends are one type of distribution paid to a taxpayer by a corporation - types of dividends are:
    - Ordinary dividends, nontaxable distributions and capital gain distributions.
    - There are special lower tax rates for qualifying dividends.
    - *Note:* Dividends that do not qualify are taxed at ordinary rates.

Ordinary Tax Bracket	*Qualifying Dividend Tax Rate for 2076*
10% and 15%	0%
25% through 35%	15%
39.6%	20%*
*An additional 3.8% Medicare surtax on Net Investment Income including qualifying dividends applies to high-income taxpayers. (LO 1.9)	

Learning Objective 2.3 Alimony

Alimony payments are deductible by the individual making the payments and taxable income to the person receiving the payments.

- The term "alimony," for income tax purposes, includes separate *or periodic maintenance payments* made to a spouse or former spouse.
- Payments must meet certain requirements to be considered alimony.
    - Rules for divorces prior to 1985 were different than they are now so consult the tax rules for that time period if reference to those particular rules are needed.

To qualify as alimony, payments must:

…be in cash and be received by spouse.

…be made under a decree of divorce/separation or associated written agreement

…cease upon the death of the spouse

…not be designated as anything other than alimony in the written agreement

…not be made to members of the same household

…not be child support payments

Payments contingent on age or marital status of child are not alimony and therefore nondeductible.

- *Note: Alimony paid by high-income spouse to low-income spouse will result in tax savings to high-income spouse.*
- Payments contingent on age or marital status of child are not alimony.
    - May be an important factor in determining which spouse is entitled to claim the dependency exemption for the child.

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- Child support payments must be up to date before any amounts paid may be treated as alimony.

Learning Objective 2.4 Prizes and Awards

Prizes and awards are taxable income to the recipient.

- Other awards are also generally taxable, even if they are awards given for accomplishments and without solicitation by the taxpayer.
- Certain employee achievement awards made in recognition of length of service or safety achievement can be excluded from income.
    - As a rule, the maximum excludable amount is $400
    - But if the award is given through a "qualified plan" the maximum exclusion increases to $1,600.

Learning Objective 2.5 Annuities

- An annuity is an investment that pays periodic payments to the purchaser for the remainder of his/her life.
- Standard mortality tables, based on the current age of the annuitant, are used to calculate
- Each annuity payment received contains an element of taxable income and an element of tax-free return of the original purchase price.
- To calculate the taxable portion of the payment, the tax law provides two methods
    - the Simplified Method or the general rule.

The Simplified Method

Taxpayers are generally required to use the simplified method to calculate the taxable amount of annuities started *after November 18, 1996.*

- *Note*: Non-qualified plan annuitants and some annuitants age 75 and over still have to use the general rule rather than the simplified method.
- To calculate the taxable amount, the IRS provides a Simplified Method Worksheet. The exclusion ratio is calculated at the start of the annuity and remains constant.

The General Rule

Prior to implementing the simplified method, the general rule ratio used to calculate the amount excluded for most annuities. The calculation is as follows:

$$\frac{\text{Investment in the Contract}}{\text{Annual Payment} \times \text{Life Expectancy}} \times \text{Amount Received} = \text{Excluded Amount}$$

Employee Annuities

If an employer makes periodic payments to a retirement annuity on behalf of an employee and the payments are made to a qualified retirement plan, *the contributions by the employer are not taxable to the employee*.

- Because the contributions are not taxable when they are made, they are not considered part of the employee's investment in the contract when calculating the exclusion ratio.

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Learning Objective 2.6 Life Insurance

Life insurance proceeds are excluded from gross income.

- To be excluded, proceeds must be paid to the beneficiary by reason of the death of the insured.
    - If the proceeds are taken over several years instead of in a lump sum, the insurance company pays interest on the unpaid proceeds. The interest is generally taxable income
- Early payouts of life insurance are excludable
- Payouts from viatical settlements can be excluded from gross income:
    - For terminally ill taxpayers and
    - For a chronically ill taxpayer to extent proceeds pay for long-term care.
        - These exclusions require certification by an M.D.

Learning Objective 2.7 Gifts and Inheritances

The fair market value of gifts and inheritances may be excluded from taxable income

- But income received from property after the transfer is taxable.
- Gifts given in the business setting are considered taxable income
    - If gift recipient provides service in return for gift, presumed that gift is income for the service performed.

Learning Objective 2.8 Scholarships

Scholarship dollars awarded that are used to *pay room and board are taxable*

- Scholarship dollars spent for tuition, fees, books, and course-required supplies and equipment are *exempt*.
- Payments received by students for part-time employment including work-study are taxable as compensation.

Learning Objective 2.9 Accident and Health Insurance

Taxpayers may exclude from income the entire amount received from accident or health insurance plans for payment of medical care.

- Taxpayers may also exclude any premiums paid by a taxpayer's employer from income.
- If the employer pays premiums on behalf of the employee for health, accident, or long-term care insurance, the employer may deduct them.

Learning Objective 2.10 Meals and Lodging

Meals and lodging provided by employers to employees for the convenience of the employer are generally not considered part of compensation and *so are not included in employee's taxable income.*

- Taxpayers may exclude from income the value of lodging provided by an employer if the lodging is located on the business premises and must be accepted as a requirement of employment.

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Learning Objective 2.11 Municipal Bond Interest

- Interest income earned on state or local government bonds is exempt from federal tax.

Note: The interest exclusion encourages high-income taxpayers to lend money to state and local governments at lower interest rates.

After-tax return = Tax-free interest rate/(1.00 – tax rate)

Learning Objective 2.12 Unemployment Compensation

Unemployment compensation is fully taxable and must be included in the taxpayer's gross income.

Learning Objective 2.13 Employee Fringe Benefits

All fringe benefits must be included in an employee's gross income unless specifically excluded by law as follows.

Flexible Spending Accounts

Employers may form plans which allow employees to set aside money from their salary before it is taxed to pay for one or more expenses.

- These expenses, in 2017, include
  - Dependent care accounts (maximum of $5,000)
  - Medical flexible spending accounts (up to $2,600 per year)
  - Public transportation and parking at work (up to $255/month).

Group Term Life-Insurance

Employers may pay for up to $50,000 of group term life-insurance for employees.

No-Additional-Cost Services

Employees may receive tax-free services from their employer, if it's in major line of business in which employed.

- For example - airline employee's free standby airplane ticket (employee is flying at no additional cost to the employe)r.

Education Assistance Programs

Employer may provide up to $5,250 of excludable tuition assistance.

- Requires existence of a written plan.

Qualified Employee Discounts

Employees may receive tax-free discounts from their employer

- On services, limited to 20% of typical customer price
- On merchandise, limited to mark up on product

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Working Condition Fringe Benefits
Employees may exclude from income any property or services provided by the employer that would be excluded from income anyway.

- For example: use of company car for business or subscription to an appropriate professional journal (for example, a tax journal for a CPA firm).

***De Minimis* Fringe Benefits**
Some benefits are so minimal that accounting for them is impractical.

- For example: occasional use of office equipment for personal use, Christmas turkeys, picnics, etc.

Tuition Reduction
Employees of educational institutions can exclude the value of a tuition reduction from their income if it was for undergraduate work and is available to all employees.

- Exclusion applies to employees, spouses, and dependents if a tuition reduction plan exists for them.
- Graduate students can only exclude tuition reductions if they work at the same school where they are teaching or doing research.

Athletic Facilities
Employees may exclude from gross income the value of the use of an athletic facility located onsite

Retirement Planning Fringe Benefit
Qualified retirement planning services are any retirement planning services provided to an employee and his/her spouse by an employer maintaining a "qualified employer plan."

- The exclusion *does not apply* to services that may be related to tax preparation, accounting, legal or brokerage services.

Learning Objective 2.14 Social Security Benefits

- Many taxpayers may exclude all of their Social Security earnings from gross income. Middle and upper income Social Security recipients may have to include *up to 85%* of their benefits in taxable income.
- The amount of benefits taxable is based on the taxpayer's MAGI (Modified Adjusted Gross Income).

Base Amounts Table

Base	Applies to
$32,000	Married filing jointly
$0	Married filing separately but did not live apart for the entire year
$25,000	All other taxpayers

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Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** 2017 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2017, or other tax year beginning , 2017, ending , 20 See separate instructions.

Your first name and initial	Last name	Your social security number
Albert T.	Gaytor	266 51 1966
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Allison A.	Gaytor	266 34 1967

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.
12340 Cocoshell Road

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).
Coral Gables, FL 33134

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

▲ Make sure the SSN(s) above and on line 6c are correct.

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. [X] You [X] Spouse

August 15 2018 DO NOT FILE

Filing Status

Check only one box.

1 [ ] Single
2 [X] Married filing jointly (even if only one had income)
3 [ ] Married filing separately. Enter spouse's SSN above and full name here. ▶
4 [ ] Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 [ ] Qualifying widow(er) (see instructions)

Exemptions

6a [X] **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b [X] **Spouse**

Boxes checked on 6a and 6b 2

c **Dependents:**

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
Crocker	Gaytor	261 55 1212	Son	[ ]
				[ ]
				[ ]
				[ ]

If more than four dependents, see instructions and check here ▶ [ ]

No. of children on 6c who: 1
• lived with you
• did not live with you due to divorce or separation (see instructions)

Dependents on 6c not entered above

d Total number of exemptions claimed **Add numbers on lines above ▶** 3

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 W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	65,420
8a	**Taxable** interest. Attach Schedule B if required			8a	992
b	**Tax-exempt** interest. **Do not** include on line 8a	8b	745		
9a	Ordinary dividends. Attach Schedule B if required			9a	1,585
b	Qualified dividends	9b	1,425		
10	Taxable refunds, credits, or offsets of state and local income taxes			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ [ ]			13	
14	Other gains or (losses). Attach Form 4797			14	
15a	IRA distributions 15a		b Taxable amount	15b	
16a	Pensions and annuities 16a		b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation			19	3,900
20a	Social security benefits 20a		b Taxable amount	20b	
21	Other income. List type and amount Gambling winnings			21	5,900
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶			22	77,797

Adjusted Gross Income

23	Educator expenses	23			
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24			
25	Health savings account deduction. Attach Form 8889	25			
26	Moving expenses. Attach Form 3903	26			
27	Deductible part of self-employment tax. Attach Schedule SE	27			
28	Self-employed SEP, SIMPLE, and qualified plans	28			
29	Self-employed health insurance deduction	29			
30	Penalty on early withdrawal of savings	30			
31a	Alimony paid b Recipient's SSN ▶ 667 34 9224	31a	11,500		
32	IRA deduction	32			
33	Student loan interest deduction	33			
34	Reserved for future use	34			
35	Domestic production activities deduction. Attach Form 8903	35			
36	Add lines 23 through 35			36	11,500
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶			37	66,297

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2017)

Form 1040 (2017) Page **2**

	38	Amount from line 37 (adjusted gross income)		38	66,297
Tax and Credits	39a	Check if: ☐ **You** were born before January 2, 1953, ☐ Blind. ☐ **Spouse** was born before January 2, 1953, ☐ Blind. **Total boxes checked** ▶ 39a			
	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b ☐			
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,350 Married filing jointly or Qualifying widow(er), $12,700 Head of household, $9,350	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40	12,700
	41	Subtract line 40 from line 38		41	53,597
	42	**Exemptions.** If line 38 is $156,900 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions		42	12,150
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	41,447
	44	**Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐		44	5,071
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
	46	Excess advance premium tax credit repayment. Attach Form 8962		46	
	47	Add lines 44, 45, and 46 ▶		47	5,071
	48	Foreign tax credit. Attach Form 1116 if required	48		
	49	Credit for child and dependent care expenses. Attach Form 2441	49		
	50	Education credits from Form 8863, line 19	50		
	51	Retirement savings contributions credit. Attach Form 8880	51		
	52	Child tax credit. Attach Schedule 8812, if required	52		
	53	Residential energy credit. Attach Form 5695	53		
	54	Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐	54		
	55	Add lines 48 through 54. These are your **total credits**		55	
	56	Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- ▶		56	5,071
Other Taxes	57	Self-employment tax. Attach Schedule SE		57	
	58	Unreported social security and Medicare tax from Form: **a** ☐ 4137 **b** ☐ 8919		58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		59	
	60a	Household employment taxes from Schedule H		60a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		60b	
	61	Health care: individual responsibility (see instructions) Full-year coverage ☒		61	
	62	Taxes from: **a** ☐ Form 8959 **b** ☐ Form 8960 **c** ☐ Instructions; enter code(s)		62	
	63	Add lines 56 through 62. This is your **total tax** ▶		63	5,071
Payments	64	Federal income tax withheld from Forms W-2 and 1099	64 7,907		
If you have a qualifying child, attach Schedule EIC.	65	2017 estimated tax payments and amount applied from 2016 return	65		
	66a	**Earned income credit (EIC)**	66a		
	b	Nontaxable combat pay election 66b			
	67	Additional child tax credit. Attach Schedule 8812	67		
	68	American opportunity credit from Form 8863, line 8	68		
	69	Net premium tax credit. Attach Form 8962	69		
	70	Amount paid with request for extension to file	70		
	71	Excess social security and tier 1 RRTA tax withheld	71		
	72	Credit for federal tax on fuels. Attach Form 4136	72		
	73	Credits from Form: **a** ☐ 2439 **b** ☐ Reserved **c** ☐ 8885 **d** ☐	73		
	74	Add lines 64, 65, 66a, and 67 through 73. These are your **total payments** ▶		74	7,907
Refund	75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**		75	2,836
	76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		76a	2,836
Direct deposit? See instructions.	b	Routing number ▶ **c** Type: ☐ Checking ☐ Savings			
	d	Account number ▶			
	77	Amount of line 75 you want **applied to your 2018 estimated tax** ▶	77		
Amount You Owe	78	**Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶		78	
	79	Estimated tax penalty (see instructions)	79		

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 accurately list all amounts and sources of income I received during the tax year. 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	Daytime phone number
		Boat Captain	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Homemaker	

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2017)

DRAFT AS OF AUGUST 15 DO NOT FILE

SCHEDULE B (Form 1040A or 1040)

Department of the Treasury Internal Revenue Service (99)

Interest and Ordinary Dividends

▶ Attach to Form 1040A or 1040.
▶ Go to *www.irs.gov/ScheduleB* for instructions and the latest information.

OMB No. 1545-0074

2017

Attachment Sequence No. 08

Name(s) shown on return: Albert T. and Allison A. Gaytor

Your social security number: 266-51-1966

DRAFT AS OF July 10, 2017 DO NOT FILE

Part I Interest

(See instructions and the instructions for Form 1040A, or Form 1040, line 8a.)

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

			Amount
1	List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see the instructions and list this interest first. Also, show that buyer's social security number and address ▶		
	Vizcaya National Bank		320
	Florida Electric		672
		1	
2	Add the amounts on line 1	2	992
3	Excludable interest on series EE and I U.S. savings bonds issued after 1989. Attach Form 8815	3	
4	Subtract line 3 from line 2. Enter the result here and on Form 1040A, or Form 1040, line 8a ▶	4	992

Note: If line 4 is over $1,500, you must complete Part III.

Part II Ordinary Dividends

(See instructions and the instructions for Form 1040A, or Form 1040, line 9a.)

Note: If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

			Amount
5	List name of payer ▶		
	Everglades Bank Corp.		1,025
	Grapefruit Mutual Fund		160
	Florida Sugar Corp.		400
		5	
6	Add the amounts on line 5. Enter the total here and on Form 1040A, or Form 1040, line 9a ▶	6	1,585

Note: If line 6 is over $1,500, you must complete Part III.

Part III Foreign Accounts and Trusts

(See instructions.)

You must complete this part if you **(a)** had over $1,500 of taxable interest or ordinary dividends; **(b)** had a foreign account; or **(c)** received a distribution from, or were a grantor of, or a transferor to, a foreign trust.

		Yes	No
7a	At any time during 2017, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions		X
	If "Yes," are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements		
b	If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ▶		
8	During 2017, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See instructions		X

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Qualified Dividends and Capital Gain Tax Worksheet—Line 44

Keep for Your Records

Before you begin:
- √ See the earlier instructions for line 44 to see if you can use this worksheet to figure your tax.
- √ Before completing this worksheet, complete Form 1040 through line 43.
- √ If you do not have to file Schedule D and you received capital gain distributions, be sure you checked the box on line 13 of Form 1040.

1.	Enter the amount from Form 1040, line 43. However, if you are filing Form 2555 or 2555-EZ (relating to foreign earned income), enter the amount from line 3 of the Foreign Earned Income Tax Worksheet	1.		41,447	
2.	Enter the amount from Form 1040, line 9b*	2.	1,425		
3.	Are you filing Schedule D?* ☐ **Yes.** Enter the **smaller** of line 15 or 16 of Schedule D. If either line 15 or line 16 is blank or a loss, enter -0-. ☒ **No.** Enter the amount from Form 1040, line 13.	3.	0		
4.	Add lines 2 and 3	4.	1,425		
5.	If filing Form 4952 (used to figure investment interest expense deduction), enter any amount from line 4g of that form. Otherwise, enter -0-	5.	0		
6.	Subtract line 5 from line 4. If zero or less, enter -0-	6.		1,425	
7.	Subtract line 6 from line 1. If zero or less, enter -0-	7.		40,022	
8.	Enter: $37,950 if single or married filing separately, $75,900 if married filing jointly or qualifying widow(er), $50,800 if head of household.	8.		75,900	
9.	Enter the smaller of line 1 or line 8	9.		41,447	
10.	Enter the smaller of line 7 or line 9	10.		40,022	
11.	Subtract line 10 from line 9. This amount is taxed at 0%	11.		1,425	
12.	Enter the smaller of line 1 or line 6	12.		1,425	
13.	Enter the amount from line 11	13.		1,425	
14.	Subtract line 13 from line 12	14.		0	
15.	Enter: $418,400 if single, $233,350 if married filing separately, $470,700 if married filing jointly or qualifying widow(er), $444,550 if head of household.	15.		470,700	
16.	Enter the smaller of line 1 or line 15	16.		41,447	
17.	Add lines 7 and 11	17.		41,447	
18.	Subtract line 17 from line 16. If zero or less, enter -0-	18.		0	
19.	Enter the smaller of line 14 or line 18	19.		0	
20.	Multiply line 19 by 15% (0.15)				20. 0
21.	Add lines 11 and 19	21.		1,425	
22.	Subtract line 21 from line 12	22.		0	
23.	Multiply line 22 by 20% (0.20)				23. 0
24.	Figure the tax on the amount on line 7. If the amount on line 7 is less than $100,000, use the Tax Table to figure the tax. If the amount on line 7 is $100,000 or more, use the Tax Computation Worksheet				24. 5,071
25.	Add lines 20, 23, and 24				25. 5,071
26.	Figure the tax on the amount on line 1. If the amount on line 1 is less than $100,000, use the Tax Table to figure the tax. If the amount on line 1 is $100,000 or more, use the Tax Computation Worksheet				26. 5,281
27.	**Tax on all taxable income.** Enter the **smaller** of line 25 or line 26. Also include this amount on Form 1040, line 44. If you are filing Form 2555 or 2555-EZ, do not enter this amount on Form 1040, line 44. Instead, enter it on line 4 of the Foreign Earned Income Tax Worksheet				27. 5,071

**If you are filing Form 2555 or 2555-EZ, see the footnote in the Foreign Earned Income Tax Worksheet before completing this line.*

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Income Tax Fundamentals 2018

Chapter 2

Gross Income & Exclusions

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Learning Objectives, Part 1

- Understand and apply definition of gross income
- Determine tax treatment of income categories such as interest, dividends, alimony, unemployment, etc.
- Calculate taxable portion of annuities
- Identify exclusions from gross income such as life insurance proceeds, fringe benefits, scholarships, inheritances and gifts, etc.

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Learning Objectives, Part 2

- Explain tax treatment of health insurance
- Identify common employee fringe benefit income exclusion
- Determine municipal bond interest tax treatment
- Apply rules governing inclusion of Social Security payments as income

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Defining Gross Income

- Tax code defines gross income as “All income from whatever source derived”
- This means all sources of income are included **unless specifically excluded**
  - See Table 2.1 on page 2-3 for inclusions
  - See Table 2.2 on page 2-3 for exclusions
  - Non-cash items included at fair market value
  - Barter transactions are includable

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Interest Income

- If total interest income >$1,500, must report on Schedule B of Form 1040
- Interest is reported in year received for cash basis taxpayers
  - Fair market value of gifts/services a taxpayer receives for making long-term deposits or opening an account are taxable interest

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U.S. Government Bonds, Part 1

- Series EE bonds
  - Purchase at discount and then redeem
    - Interest is generally taxed year bonds are redeemed
- Series HH bonds
  - Issued at face value
    - Pay interest semiannually and interest is taxed each year
    - Treasury stopped issuing 8/04, but there are still outstanding HH bonds paying interest

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U.S. Government Bonds, Part 2

- Series I bonds
  - Purchase for face value
    - Earnings are adjusted semiannually for inflation
    - Interest taxed each year or at maturity

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Dividend Income

- 3 kinds of dividends
  - Ordinary dividends are most common
    - Return of net income to shareholders
    - Schedule B when total dividend income > $1,500
  - Nontaxable distributions are return of original investment - not paid from corporation's earnings and profits
    - Not included in taxpayer's income and reduces basis in stock
  - Capital gain distributions (CGD)
    - When stock reaches zero basis, further distributions are CGD
    - Report on page 1 of Form 1040 or Schedule D of Form 1040

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Tax Rates for Dividends

- "Qualifying dividends" are classified by corporations issuing dividends and brokerage firms holding stock investments

Regular tax bracket	***Qualifying Dividend Rate***
10-15%	0%
25-35%	15%
39.6%	20%
High Income Taxpayers Medicare Surtax	3.8%

- If not "qualifying," dividends taxed at ordinary rates

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Alimony

- Alimony is deductible to payer and taxable to payee
- Alimony payments must meet *five requirements* as follows (if subject to divorce agreement after 1984)
  - Must be in cash and received by ex-spouse
  - Must be made in connection with written instrument
  - Can't continue after death of ex-spouse
  - Can't be designated as anything other than alimony
  - Parties may not be members of the same household

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Other Issues with Alimony

- Recapture provisions prevent front-end loading of alimony payments
- Property transfer is not alimony because it's not cash
  - Transferor doesn't have to recognize any gain on transaction
  - Transferee's basis in property is same as transferor's

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Alimony Example

Example

Complying with a 2017 written divorce decree, Frederik pays Shanna $1,800/month. The decree specifies that the payments will be reduced 40% when their daughter, in Shanna's custody, becomes eighteen. How much can Frederik deduct per year as alimony?

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Solution, Part 1

Example

Complying with a 2017 written divorce decree, Frederik pays Shanna $1,800/month. The decree specifies that the payments will be reduced 40% when their daughter, in Shanna's custody, becomes eighteen. How much can Frederik deduct per year as alimony?

Solution

40% of each payment is considered nondeductible child support; therefore, $1,800 x 12 months x 60% = *$12,960/year deductible alimony.*

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Child Support

- Child support is not deductible to payer and not taxable to payee
- If payer falls behind on child support, he/she must bring this current before any portion of payments can be considered alimony
- Rules differ for divorce agreements executed pre- and post-1985

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Prizes/Awards

- Taxable amount equal to cash prize or fair market value of property

  Exception: Employee awards of tangible personal property (up to $400) received for recognition of length of service or safety achievement are excludable. Up to $1,600 may be excluded, if it is granted under a "qualified plan award."
- Game show and reality TV show winners should be aware that prizes/awards are taxable

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Prize/Award Example

Example

Josef, an employee of Vesuvius Statuaries LLC, receives a clock for 20 years of service valued at $1,500 and the award is not considered a “qualified plan award;” how much is excludable from Josef’s gross income?

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Solution, Part 2

Example

Josef, an employee of Vesuvius Statuaries LLC, receives a clock for 20 years of service valued at $1,500 and the award is not considered a “qualified plan award;” how much is excludable from Josef’s gross income?

Solution

$400 is excluded and $1,100 would have to be included in Josef’s gross income calculation

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Annuities/Pensions, Part 1

- An annuity is an instrument that a taxpayer buys (usually at retirement) in return for periodic payments for the remainder of his/her life
- The taxable portion of these periodic payments is calculated based on

  Mortality tables provided by IRS *and* The annuity purchase price

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Annuities/Pensions – Simplified Method

- Individuals generally required to use this method to calculate taxable amount from an annuity - if annuity payments commenced after 11/18/96
- Taxpayer must fill in simplified method worksheet provided by IRS
  - See pp. 2-12 through 2-14 for example of simplified method worksheet

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Annuities/Pensions, Part 2

- General Rule
  - Payments received are both taxable (income) and nontaxable (return of capital)
  - Must calculate amount to exclude from income

1. First, calculate exclusion ratio

   Investment in Contract / (Annual payment x Life expectancy)

2. Secondly, find the amount to exclude

   Exclusion Ratio (from step 1) *x Annual Amount of Annuity Received*

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Annuities/Pensions Example

Example

Din has saved $750,000 in his retirement account and uses it to purchase an annuity. His annuity equals $4,800/month and the IRS tables show he is expected to live 19 years. How much is excludable from tax each year of Din's retirement? Assume that Din is required to use the general rule.

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Solution, Part 3

Example

Din has saved $750,000 in his retirement account and uses it to purchase an annuity. His annuity pays $4,800/month and the IRS tables show he is expected to live 19 years. How much is excludable from tax each year of Din's retirement? Assume that Din is required to use the general rule.

Solution

$750,000/($4,800 *x* 12 months *x* 19 years) = .685

.685 = 68.5% of amount is excluded from tax

.685 *x* ($4,800 *x* 12 months) = *$39,456 annual exclusion*

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Employee Annuities

- Employers may make periodic payments to retirement plans on behalf of their employees
- These payments are not taxable to employee in current year
- They are not considered part of investment when calculating exclusion ratio

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Life Insurance Proceeds

- Life insurance proceeds are excluded from gross income if:
  - Proceeds paid to beneficiary by reason of death of the insured *and*
  - Beneficiary has an insurable interest

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Life Insurance Proceeds Example

Example

Karina dies on 6/15/17, leaving her husband, Dann, a $500,000 life insurance policy. The proceeds will be paid out to Dann $100,000 per year plus interest for 5 years.

In the current year, Dann receives $105,000 ($100,000 + $5,000 interest). How much is taxable to Dann in the current year?

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Solution, Part 4

Example

Karina dies on 6/15/17, leaving her husband, Dann, a $500,000 life insurance policy. The proceeds will be paid out to Dann $100,000 per year plus interest for 5 years. In the current year, Dann receives $105,000 ($100,000 + $5,000 interest). How much is taxable to Dann in the current year?

Solution

Dann must include the $5,000 of interest income in his gross income calculation; the face value of $100,000 is not taxable.

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Viatical Settlements

- Also known as accelerated death benefits
- Viatical settlements are excludable from gross income in certain situations
  - Chronically or terminally ill taxpayer collects early payout from insurance company or sells/assigns policy to a viatical settlement provider
    - Terminally ill patient must have certification from MD stating that he/she reasonably expected to die within 24 months
    - Chronically ill must have certification from MD stating the he/she is unable to perform daily living activities unassisted

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Life Insurance Policy Transferred for Value

- If policy is transferred for value, then all or part of the proceeds may be taxable to recipient

  Taxable amount = Proceeds from death of insured - Cash surrender value at time of transfer + Premiums paid by purchaser
- Exception: if policy is transferred for value to partner of insured, a partnership in which insured is a partner or a corporation in which insured is an officer, then policy proceeds are *not* taxable

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Life Policy Transfer Example

Example

Bianca transfers a life insurance policy with a face value of $25,000 and cash surrender value of $4,000 to Yvette as payment for services rendered. Yvette pays premiums of $500 per year for a total of $1,500 in the ensuing 3 years; Bianca dies and Yvette collects the $25,000. How much must Yvette include in her gross income?

How would this answer differ if Yvette and Bianca were partners in a partnership?

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Solution, Part 5

Example

Bianca transfers a life insurance policy with a face value of $25,000 and cash surrender value of $4,000 to Yvette as payment for services rendered. Yvette pays premiums of $500 per year for a total of $1,500 in the ensuing three years; Bianca dies and Yvette collects the $25,000. How much must Yvette include in her gross income? How would this answer differ if Yvette and Bianca were partners in a partnership?

Solution

Yvette must include $19,500 in income [$25,000 – $4,000 + $1,500].

If Yvette and Bianca were partners in a partnership, the entire proceeds ($25,000) would be tax-free.

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Gifts & Inheritances

- Inheritances are excluded from income
  - Any income generated from property received after transfer is taxable
  - Estate may incur taxes
- Gifts received are excluded from income
  - A gift is defined by the courts as a voluntary transfer of property without adequate consideration
  - Gifts in business settings usually considered taxable income
  - If recipient renders services for the gift, amount is taxable

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Scholarships

- Scholarships received for fees, books, tuition, course-required supplies or equipment are excluded from income
- Must include scholarship amounts in income for:
  - Any amounts applied to room and board
  - Any amounts received as compensation for required work (including work study)

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Employer Paid Accident & Health Insurance Premiums

- Taxpayers may exclude from income the total amount received for
  - Payment of medical care
  - Payment for loss of a body member or function (called accidental death and dismemberment)
- Premiums paid by employer on employee's behalf are excluded from income
  - For medical insurance
  - For accidental death and dismemberment insurance

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Meals and Lodging

- Meals and lodging provided by employer are generally excluded from income (if following tests are met)

  (1) Meals provided by employer on premises during working hours *solely for the benefit of the employer* because employee must be available for emergency calls or is limited to short meal periods

  (2) Lodging provided by employer on premises and must be accepted as a requirement for employment

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Municipal Bond Interest

- Taxpayer may exclude interest on state and local government obligations (called “muni bonds”) from federal taxation
- After-tax return for tax-free bond calculated as follows

  After-tax return = Tax-free interest rate / (1.00 – taxpayer’s tax rate)

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Municipal Bond Interest Example

Example

Gopal is in the 33% federal income tax bracket and invests in a Nashville City Bond paying 6%. What taxable interest rate will yield the same after-tax return as the municipal bond?

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Solution, Part 6

Example

Gopal is in the 33% federal income tax bracket and invests in a Nashville City Bond paying 6%. What taxable interest rate will yield the same after-tax return as the municipal bond?

Solution

Taxable interest rate equivalent = 8.96%

(.06) / (1.00 - .33) = .0896

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Unemployment Compensation

- Unemployment compensation payments are fully taxable in 2017
- These payments are deductible on some state's income tax returns

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Employee Fringe Benefits: Employer-Provided Spending Accounts, Part 1

- Employer-sponsored plan allowing employees to set aside pretax dollars for:
  - Dependent Care flexible spending accounts (FSAs) up to $5,000/year
  - Health Care FSAs up to $2,600/year
    - Health insurance co-pays, medical care
    - Dental work, optical care, prescription costs
  - Public transport/parking/commuter biking costs up to certain limits

  Can result in significant tax savings for employee

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Employee Fringe Benefits: Employer-Provided Spending Accounts, Part 2

- "Use-it-or-lose-it" provision
  - If amounts are left in FSAs after certain date, employee loses them
  - Can carryover up to $500 of unused amounts into a 3-month grace period into the next year

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Employee Fringe Benefits, Part 1

- May exclude certain fringe benefits from gross income, such as:
  - Employer-paid premiums for group term life insurance (face value up to $50,000)
  - Education assistance plans (up to $5,250/year)
  - Qualified employee discounts (with exceptions)
  - Working condition fringe benefits - excludable if you could deduct item on your own as an employee

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Employee Fringe Benefits, Part 2

- De minimis fringe benefits (immaterial - not worth tracking)
- Tuition reduction for undergraduate and available to all employees
- Value of membership to onsite athletic facilities
- Retirement planning services
- Other excludable fringes (see Table 2.3 on page 2-24)

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Social Security Benefits

- Part of Social Security benefits may be included in gross income
  - Maximum inclusion amount = 85%
- Inclusion based on taxpayer's Modified AGI (MAGI)
  - MAGI = AGI + tax-exempt interest (and other items)
- If [MAGI + (50%)(SS benefits)] < base amount* then benefits are not includable

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Calculating Taxable Amount of SS Benefits

If [MAGI + (50%)(SS benefits)] exceeds base amount as follows:

Base Amount	Filing Status
$32,000	MFJ
$25,000	All others

…then, the taxable amount is calculated by completing the Simplified Taxable Social Security Worksheet (pages 2-25 – 2-26)

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