

TEST BANK

2016

WHITTENBURG/ALTUS-BULLER/GILL

Income Tax FUNDAMENTALS



Includes
MyLab
Tax

CHAPTER 2
GROSS INCOME AND EXCLUSIONS

TEST BANK

TRUE OR FALSE QUESTIONS

1. Noncash items received as income must be included in income at their fair market value.
2. A gift received for opening a bank account is not taxable income to the recipient.
3. Interest income received by a cash basis taxpayer is generally reported in the tax year it is received.
4. When calculating the exclusion ratio for an annuity, the ratio should be revised when there is a significant change in the taxpayer's status or health.
5. Amounts received as scholarships for books and tuition may be excluded from the recipient's taxable income.
6. If a life insurance policy is transferred to the insured's partnership for valuable consideration, the insurance proceeds are taxable when received by the partnership.
7. The receipt of an inheritance is excluded from the taxable income of the recipients.
8. Cash allowances for meals or lodging generally must be included in the employee's income.
9. An auto that is received as a prize should be included in the taxpayer's income at its list price rather than its fair market value.
10. Awards, bonuses, and gifts are all included in gross income.
11. Taxpayers must report interest income on Series EE savings bonds as the interest accrues.
12. The value of lodging provided to a professor to enable him to live near the campus is excluded from gross income.
13. Under a divorce agreement executed in 2009, periodic payments of either cash or property must be made at regular intervals to be deductible as alimony.
14. If a divorce agreement executed in 2009 specifies that a portion of the amount of an alimony payment is contingent upon the status of a child, that portion is considered to be a child support payment.
15. Dr. J's outstanding player award is not includible in income, since the award is in recognition of his outstanding performance.
16. If an annuitant, whose annuity starting date was January 1, 2001, dies before recovering his or her investment in the annuity, any unrecovered investment is recognized as a loss on the annuitant's tax return for the year of death.

17. Payments made by an employer for health insurance on behalf of an employee are considered income to the employee at the time the payments are made.
18. Unemployment compensation in excess of \$2,400 is fully taxable to the individual receiving the compensation.
19. Dividend income arising from stock received as a gift is excluded from gross income since the dividends are considered part of the gift.
20. To promote business activity, the tax rules generally are very liberal in allowing business gifts as deductions.
21. Amounts received by an employee as reimbursement for medical expenses under a policy provided by the taxpayer's employer are excluded from gross income.
22. If an employer claims a business deduction for group health insurance premiums paid on behalf of his employees, the amount must be included in the employees' gross income.
23. In some cases, Social Security benefits may be partially taxable.
24. Payments made to a qualified retirement plan by an employer are considered part of the employee's investment in the contract for calculation of the annuity exclusion ratio.
25. Disability benefits are generally taxable to the individual receiving the amounts.
26. A scholarship for room and board granted in 2009 is fully taxable to the recipient.
27. Interest earned on bonds issued by a state government is fully taxable.
28. Child support payments are deductible by the spouse making the payments.
29. Interest on U. S. Treasury Bonds is not taxable.
30. Group term life insurance premiums paid by an employer for insurance amounts less than \$50,000 must be included in the employee's income.
31. A "no-additional-cost" service includes only those services in the major line of business in which the employee is employed.

MULTIPLE CHOICE QUESTIONS

1. All of the following amounts are taxable income to the recipient *except*:
 - a. Prizes
 - b. Unemployment compensation
 - c. Salaries
 - d. Farm income
 - e. Gifts

2. Mary received the following items during 2009:

Christmas bonus from her employer	\$500
Christmas gift from her father	35

Prize won in a radio show contest

100

What is the total amount of the above items that must be included in Mary's 2009 gross income?

- a. \$0
 - b. \$100
 - c. \$500
 - d. \$600
 - e. \$635
3. Which of the following amounts must be included in the gross income of the recipient?
 - a. Child support payments
 - b. Welfare payments
 - c. Gifts
 - d. Royalties
 - e. All of the above are included in gross income
 4. All of the following amounts must be included in gross income, *except*:
 - a. Gambling winnings
 - b. Partnership income
 - c. Accident insurance proceeds
 - d. Dividends
 - e. Jury duty fees
 5. All of the following amounts are excluded from gross income, *except*:
 - a. Tips and gratuities
 - b. Child support payments
 - c. Scholarship grants for tuition
 - d. Gifts
 - e. Veterans' benefits
 6. Which of the following is generally excluded from gross income?
 - a. Dividends
 - b. Rewards
 - c. Disability benefits
 - d. Passive income
 - e. None of the above
 7. As a Christmas thank-you for being a good employee, Ed's TV Repair gave 62-year-old Edwina three shares of its stock worth \$20 per share. Edwina then received dividends of \$1 per share related to the stock. How much should be included in Edwina's gross income?
 - a. \$0
 - b. \$3
 - c. \$60
 - d. \$63
 - e. None of the above
 8. Elmer received the following distributions from Virginia Mutual Fund for the calendar year 2009:

Ordinary dividends (nonqualifying)	\$250
Capital gain distributions	170

Nontaxable distributions

80

Elsie, Elmer's wife, did not own any of the Virginia Mutual Fund shares, but she did receive \$1,600 in interest on a savings account at the Moss National Bank. Elmer and Elsie filed a joint income tax return for 2009. What portion of the distributions from Virginia Mutual Fund is taxable as ordinary income on their 2009 individual income tax return?

- a. \$0
- b. \$250
- c. \$420
- d. \$500
- e. None of the above

9. Elmer received the following distributions from Virginia Mutual Fund for the calendar year 2009:

Ordinary dividends	\$250
Capital gain distributions	170
Nontaxable distributions	80

Elsie, Elmer's wife, did not own any of the Virginia Mutual Fund shares, but she did receive \$175 in interest on a savings account at the Moss National Bank and \$1,475 in interest on California Municipal Bonds. Elmer and Elsie filed a joint income tax return for 2009. What amount is reportable as interest income?

- a. \$0
- b. \$175
- c. \$1,475
- d. \$1,650
- e. None of the above

10. Which of the following is excluded from gross income?

- a. Prizes
- b. Scholarships for tuition
- c. Hobby income
- d. Rental income
- e. All of the above are included in gross income

11. Laura and Leon were granted a divorce in 2004. In accordance with the decree, Leon made the following payments to Laura in 2009:

Child support payments contingent on the age of the child	\$4,000
Annual cash payments, other than child support, specified as alimony in the divorce agreement	\$6,000

How much should Laura include in her 2009 taxable income as alimony?

- a. \$0
- b. \$6,000
- c. \$10,000
- d. \$4,000
- e. None of the above

12. Laura and Leon were granted a divorce in 2004. In accordance with the decree, Leon made the following payments to Laura in 2009:

Child support payments contingent on the age of the child	\$4,000
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Indefinite periodic payments terminating on Laura's death \$6,000

Assuming that Leon does not itemize his deductions, how much of the payments can he deduct as alimony in 2009?

- a. \$0
 - b. \$6,000
 - c. \$10,000
 - d. \$4,000
 - e. None of the above
13. Sam died on January 15, 2003 and left his wife, Terry, an insurance policy with a face value of \$100,000. Terry elected to receive the proceeds over a 10-year period (\$10,000 plus interest each year). This year Terry receives \$11,500 (\$10,000 proceeds plus \$1,500 interest) from the insurance company. How much income must Terry report from this payment?
- a. \$0
 - b. \$500
 - c. \$1,500
 - d. \$11,500
 - e. None of the above
14. Roger is required under a 2003 divorce decree to pay \$500 of alimony and \$200 of child support per month for 12 years. In addition, Roger makes a voluntary payment of \$100 per month. How much of the total monthly payment is deductible by Roger?
- a. \$0
 - b. \$200
 - c. \$500
 - d. \$600
 - e. None of the above
15. Sam, a calendar year taxpayer, purchased an annuity contract for \$3,600 that would pay him \$120 a month beginning on January 1, 2009. His expected return under the contract based on his life expectancy is \$10,800. Assuming Sam received a total of \$1,440 in payments during 2009, how much of this annuity income is included in Sam's gross income for 2009, using the general rule?
- a. \$0
 - b. \$480
 - c. \$960
 - d. \$1,440
 - e. None of the above
16. Richard, who retired on April 30, 2009, receives a monthly employee annuity benefit of \$1,400 payable for life, beginning May 1, 2009. During his years of employment, Richard contributed \$29,400 to the company's plan. Richard's life expectancy from the IRS tables is 10 years. Using the general rule, how much of the annuity payment amounts received during 2009 (\$11,200) may Richard exclude from gross income?
- a. \$1,960
 - b. \$2,940
 - c. \$9,240
 - d. \$11,200
 - e. None of the above
17. In 2009, Uriah received the following interest payments:
Interest of \$400 on an overpayment of 2006 Federal income taxes
Interest of \$300 from his bank certificate of deposit

Interest of \$1,500 on municipal bonds

Interest of \$1,000 on United States savings bonds (Series HH)

What amount, if any, should Uriah report as taxable interest income on his 2009 individual income tax return?

- a. \$0
- b. \$700
- c. \$1,700
- d. \$3,200
- e. None of the above

18. Seymore named his wife, Penelope, the beneficiary of a \$100,000 insurance policy on his life. The policy provided that, upon his death, the proceeds would be paid at a rate of \$4,000 per year plus interest over a 25-year period. Seymore died June 25, 2008 and in 2009 Penelope received a payment of \$5,200 from the insurance company. What amount should she include in her gross income for 2009?

- a. \$200
- b. \$1,200
- c. \$4,000
- d. \$5,200
- e. None of the above

19. Arthur, age 19, is a full-time student at Gordon College and is a candidate for a bachelor's degree. During 2009 he received the following amounts:

Tuition scholarship	\$2,400
Loan from college financial aid office	1,000
Cash support from parents	2,000
Ordinary cash dividend	500
Cash prize awarded in contest	300

What is his adjusted gross income for 2009?

- a. \$700
- b. \$800
- c. \$3,200
- d. \$6,200
- e. None of the above

20. Jerry and Sally were divorced under an agreement executed July 1, 2009. The terms of the agreement provide that Jerry will transfer to Sally his interest in a rental house worth \$250,000 with a tax basis to Jerry of \$80,000. What is the amount of the gain that must be recognized by Jerry on the transfer of the property and what is Sally's tax basis in the property after the transfer, respectively?

- a. \$170,000 and \$250,000
- b. \$0 and \$250,000
- c. \$170,000 and \$170,000
- d. \$0 and \$80,000
- e. None of the above

21. Richard and Alice are divorced and under the terms of their written divorce agreement signed on December 30, 2006, Richard was required to pay Alice \$1,500 per month of which \$600 was designated as child support. He made twelve such payments in 2009. Additionally, Richard voluntarily paid Alice \$1,200 per month for twelve months of 2009, no portion of which was designated as child support. Assuming that Alice has no other income, her tax return for 2009 should show gross income of:
- \$0
 - \$10,800
 - \$18,000
 - \$25,200
 - None of the above
22. Terry receives \$3,000 annually from an annuity contract which she purchased in 2001 for \$15,000. Her total expected return under the contract is \$45,000 and payments under the contract began in 2002. For the years 2002 through 2009, Terry received \$3,000 per year. Of the \$3,000 received during 2009, what amount must Terry include in her gross income for 2009 under the general rule?
- \$3,000
 - \$2,062
 - \$2,000
 - \$1,000
 - None of the above
23. Which of the following fringe benefits is taxable to the employee receiving the benefit?
- A subscription to a tax journal provided by the employer to a corporation's tax accountant
 - A small discount on toys granted to the salesperson for a toy store
 - Incidental use of the company's copier by an office worker
 - A 15 percent discount on investment real estate granted to the employee of a real estate developer
 - All of the above are tax-free
24. Which of the following is nontaxable income to the recipient for tax purposes?
- Salary income
 - Income from real estate rental property
 - Income from tips
 - Inheritances
 - None of the above
25. Which of the following is classified as nontaxable income?
- Unemployment compensation
 - Dividend income
 - Income from real estate rental property
 - Welfare payments
 - None of the above
26. Which of the following would result in life insurance proceeds that are taxable to the recipient?
- A life insurance policy transferred to a creditor in payment of a debt
 - A life insurance policy in which the insured is the daughter of the taxpayer and the beneficiary is the taxpayer
 - A life insurance policy transferred by a shareholder to a corporation
 - A life insurance policy purchased by a taxpayer insuring his or her business partner
 - A life insurance policy purchased by a corporation insuring an officer.

27. For 2009, the maximum percentage of Social Security benefits which must be included in a taxpayer's gross income is?
- 0%
 - 50%
 - 65%
 - 85%
 - 100%
28. Employer-provided spending accounts:
- May be set up for tax-free vacation savings
 - Are not allowed for dependent care
 - Do not require that the employee provide receipts for the expenses incurred
 - Allow qualifying expenses to be treated as tax-free reductions in the employees' salaries
29. Indicate which of the following statements is true.
- Dependent care plans can only be used to cover the costs of caring for a dependent child.
 - Medical flexible spending accounts can be used to cover some over-the-counter drugs.
 - Public transportation may be covered by an employer-provided spending account, but parking can not be covered.
 - Dependent care accounts may include day care but not preschool
30. Which of the following is correct?
- Employee discounts are always included in gross income.
 - Employee discounts of up to 20 percent may be taken on personal property held for investment
 - Employee discounts are not tax-free if they exceed the employer's gross markup for merchandise
 - Tax-free employee discounts include discounts in lines of business in which the employee does not work.
31. For divorces after 1984, which of the following statements about alimony payments is not correct?
- The payments must be in cash and must be received by the spouse (or former spouse)
 - Divorced or legally separated parties can be members of the same household at the time the payments are made
 - The payor must have no liability to make payments for any period following the death of the spouse receiving the payments
 - The payments must not be designated in the written agreement as anything other than alimony
32. In the tax law, the definition of gross income is:
- All cash payments received unless excluded by the tax code
 - All cash payments received for services performed
 - All income from whatever source derived
 - All income of any kind unless the income is earned illegally

PROBLEMS

- Toby transfers to Jim a life insurance policy with a face value of \$25,000 and a cash value of \$5,000 in payment of a personal debt. Jim continues to make premium payments on the policy until Toby's death. At that time, Jim had paid \$1,500 in premiums.
 - How much income must Jim report when he receives the \$25,000 in proceeds?
 - Would your answer be different if Toby and Jim were partners in a partnership? Why?

2. During the 2009 tax year, Thomas and Yolanda received \$24,000 in Social Security benefits. The amount of their adjusted gross income for the year was \$2,000 and they received no tax-exempt interest income. Calculate the amount of the Social Security benefits that Thomas and Yolanda must include in their gross income for 2009.
3. A taxpayer in the 33% tax bracket invests in a New York City Bond paying 5% interest. What taxable interest rate would provide the same after-tax return?
4. Martin retired in May, 2009. His pension is \$1,000 per month from a qualified retirement plan to which he contributed \$48,000, and to which his employer contributed \$12,000. Martin’s life expectancy from the IRS mortality tables is 10 years, and during 2009 he received total payments of \$8,000 from the plan.
 - a. Using the general rule, calculate Martin’s taxable income for 2009 from the retirement plan distributions.
 - b. If Martin’s contributions to the plan had been \$25,000, instead of \$48,000, how much taxable income would he have to report in 2009 from the plan distributions?

5. William, a single taxpayer, works for the men’s clothing division of a large corporation. During 2009, William received the following fringe benefits:

	<u>Value</u>
20 percent discount on men’s clothing (the usual markup is 40 percent)	\$350
15 percent discount on toys from the toy division of the company (the usual markup is 25 percent)	100
Personal copies on the company’s copier	15
A subscription to <i>Men’s Clothing Weekly</i>	35
Use of the company’s athletic facilities	50

As a result of receiving the above fringe benefits, what amount must William include in his 2009 gross income?

6. Under a divorce agreement executed in 2009, Bob is required to pay his ex-wife, Carol, \$3,000 a month until their youngest daughter is 21 years of age. At that time, the required payments are reduced to \$2,000 per month.
 - a. How much of each \$3,000 payment may be deducted as alimony by Bob?
 - b. How much of each \$3,000 payment must be included in Carol’s taxable income?
7. Under the terms of a property settlement executed during 2009, Cindy transferred a house worth \$350,000 to her ex-husband, Carl. The property has a tax basis to Cindy of \$300,000.
 - a. How much taxable gain or loss must be recognized by Cindy at the time of the transfer?
 - b. What is Carl’s tax basis in the property he received from Cindy?
8. In June of 2009, a wealthy aunt gave Janie a stock portfolio worth \$150,000. During the year, she collects \$4,000 in dividends. How much of these amounts, if any, should Janie include in gross income for 2009? Why?
9. Joey is a single taxpayer. Joey’s employer pays \$1,800 per year for his health insurance. During the year, Joey had medical expenses of \$2,500 and the insurance company reimbursed him for the full \$2,500. How much of the above amounts, if any, must be included in Joey’s gross income? Why?
10. Rob is 8 years old and won a sports car valued at \$30,000 in a drawing at Disneyland. How much income, if any, must Rob report on his 2009 tax return? Why?

11. Bob is a machinist in a remote Alaskan crab-freezing plant. The plant is accessible only by boat or airplane and has no available lodging for rent. Bob’s employer provides him with lodging at the plant and pays for all of his electricity, gas, and other utilities, valued at \$700 per month. Is the value of the lodging taxable to Bob? Explain.
12. Jim, a single individual, was unemployed for a few months during 2009. During the year, he received \$3,600 in unemployment compensation payments. How much of his unemployment compensation payments must be included in gross income?
13. Tracy transfers to Glen a life insurance policy with a face value of \$40,000 and a cash value of \$8,000 in payment of a personal debt. Glen continues to make premium payments on the policy until Tracy’s death. At that time, Glen had paid \$3,500 in premiums.
 - a. How much income must Glen report when he receives the \$40,000 in proceeds?
 - b. Would your answer be different if Tracy were a shareholder and CEO of a corporation to which the policy was transferred? Why?
14. Elmore receives a rental property as an inheritance from his grandmother. The rental is worth \$500,000 and Elmore collected rental income of \$24,000 during the year.
For the year, what is Elmore’s taxable income from the inheritance?
15. In 2009, what rate would a taxpayer pay on qualified dividend income:
 - a. If in the 33% bracket?
 - b. If in the 10% bracket?
16. Bonnie receives salary income of \$30,000, unemployment compensation of \$5,400, and dividend income of \$1,000 and a gift of \$7,000 in cash from her aunt. How much total income does Bonnie have?
17. In June of 2009, Rob’s wealthy stepmother died and left him a stock portfolio worth \$600,000. Before she died, she gave him a gift of \$20,000 in cash. How much of these amounts, if any, are taxable to Rob? Why?
18. A taxpayer in the 28% tax bracket invests in a City of San Diego bond paying 8% interest. What taxable interest rate would provide the same after-tax return?
19. Andy landscaped his friend’s house in return for a couch set and a plasma television worth \$8,000. How much income must Andy report on his tax return for his services?

20. Jack is a lawyer and Jeri is a child psychologist. Jack prepares Jeri’s estate planning at no charge and Jeri agrees to counsel Jack’s daughter six times at no charge in return for the estate planning. The value of the estate planning is \$1,000 and the value of the therapy sessions is \$1,000.
 - a. How much income does Jack have? Why? _____
 - b. How much income does Jeri have? Why? _____
21. Barry has a successful methamphetamine laboratory. Producing methamphetamine is illegal under Federal law. Is Barry required by law to report the income from his lab on his tax return? Why?

22. Qualified dividends are given special tax treatment. Describe how they are taxed.
-
23. If a taxpayer holding EE bonds makes an election with respect to the taxation of the bonds, how is the interest which accrues on the bonds, but is not paid, taxed each year?
24. Peter is required by his divorce agreement to pay alimony of \$6,000 a month and child support of \$4,000 a month to his ex-wife Stella. What is the tax treatment of these two payments?
 To Peter? _____
 To Stella? _____
25. As part of the property settlement related to their divorce, Stella must give Peter the house that they have been living in, while she gets 100% of their savings accounts. The house was purchased in Texas fifteen years ago for \$100,000 and is now worth \$110,000. How much gain must Stella recognize on the transfer of the house to Peter? What is Peter's tax basis in the house for calculating any future sale of the house?
-
26. Which of the following is taxable?
 a. Susan won a jackpot of \$50,000 gambling at a casino. _____
 b. Sarah received a Christmas ham from her employer. _____
 c. Jonathan won a car in a supermarket raffle valued at \$25,000. _____
 d. Gary received a scholarship for tuition of \$5,000 a year. _____
 e. Eric is given lodging valued at \$1,000 a month on the oil rig where he works since it is impossible to go home during the period of time he is assigned to work there. _____
27. Van is sick and tired of his job. His doctor certifies that his health may be compromised if he continues to work at his current job. He sells his life insurance policy to Life Settlements, Inc. for \$50,000 so he can take a break from work. He has paid \$10,000 so far for the policy. How much of the \$50,000 must Van include in his taxable income?
28. Helga receives a \$300,000 life insurance payment when her boyfriend Andy dies. How much of the payment is taxable to Helga?
29. Geoff is a company president who has had a very good year at work. The owner of the company is pleased and gives him a gift of \$50,000 at the end of the year. The owner writes "gift" in the memo section of the check. How much of the gift is taxable to Geoff?
30. Tim receives a \$25,000 gift from his parents for a down payment on a house. They know he can not buy a house without their help. They write "gift" in the memo line of the check. How much of the gift is taxable to Tim? _____
31. Karina receives a scholarship of \$10,000 to a college. She is also given a job which pays \$5,000 a year to help with her expenses. \$7,000 of the scholarship is earmarked for tuition and \$3,000 is for room and board. How much of the money from the scholarship and the job are taxable to Karina?
-
32. Marco and his family are covered by his company's health insurance plan. The health insurance costs his company \$2,500 a year. During the year Marco's daughter is diagnosed with a serious illness and the health insurance pays \$25,000 for treatment. How much of the insurance cost and the treatment are taxable to Marco?

33. Mable is a wealthy widow who has come to you for tax advice. She is in the 35% tax bracket. She has a choice between investing in a high-quality municipal bond paying 3.5% or a high-quality corporate bond paying 7%. From a tax standpoint, which investment would you advise her to make and why?
-
34. Answer the following questions regarding the taxability of Social Security payments.
- Will a taxpayer with no income other than Social Security have to include the Social Security in taxable income? _____
 - Will a taxpayer with a large amount of municipal bond income, but no taxable income, likely have to pay tax on part of his or her Social Security? _____
 - What is the maximum amount of Social Security which may be subject to tax on an individual's tax return? _____
35. Curt's tax client is employed at a large company that offers medical flexible spending accounts to its employees. Terry, the client, must decide at the beginning of the year whether he wants to put as much as \$5,000 of his salary into the medical spending account. Terry has excellent insurance through the company and is very healthy. He does not expect to have any medical expenses during the year. Terry does not itemize deductions. Should Curt recommend that Terry put the maximum in his medical flexible spending account? Why or why not?

ESSAY QUESTIONS

- During 2009, Margaret and John received \$24,000 in Social Security benefits. The amount of their adjusted gross income for the year before any Social Security income was \$140,000 and they received \$19,000 in tax-exempt income.
Explain the treatment of their Social Security income for tax purposes and the likely percentage of the Social Security income that will be taxable to Margaret and John.
- Ordinarily life insurance proceeds are excluded from gross income. Why would they be taxable if earlier the policy had been transferred for valuable consideration?

MATCHING

Indicate whether each of the items listed below would be included (A) in or excluded (B) from gross income for the 2009 tax year.

A. Included B. Excluded

- Alimony _____
- Lottery winnings _____
- Life insurance proceeds received upon the death of a family member _____
- Child support payments _____
- Reimbursement of hospital expenses from a health insurance plan _____
- Municipal bond interest _____
- Unemployment compensation in excess of \$2,400 for 2009 _____
- Scholarships for tuition and books _____
- Wages _____
- Farm income _____
- Inheritances _____