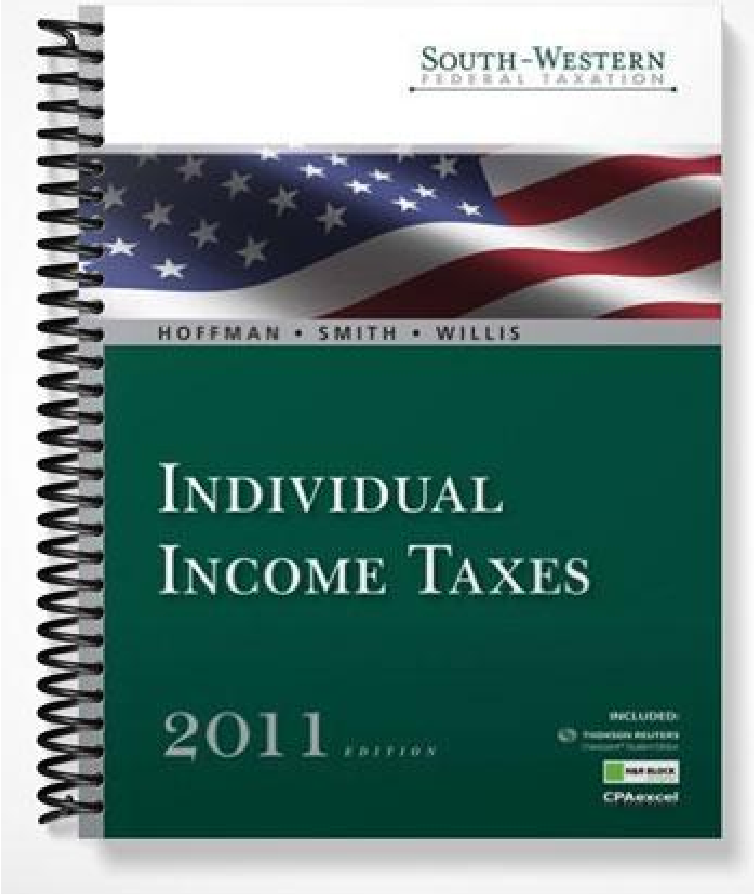
TEST BANK


SOUTH-WESTERN
FEDERAL TAXATION
HOFFMAN • SMITH • WILLIS
INDIVIDUAL
INCOME TAXES
2011 EDITION
INCLUDED:
CPAexcel

CHAPTER 3--TAX FORMULA AND TAX DETERMINATION; AN OVERVIEW OF PROPERTY TRANSACTIONS

Student: ____

1. Currently, the *top* Federal income tax rate in effect is the highest it has ever been.

   True False

2. As used in the income tax formula, *gross income* would not include the receipt of a loan the taxpayer obtained from a bank.

   True False

3. Under the income tax formula, a taxpayer must choose between deductions *for* AGI and the standard deduction.

   True False

4. An "above the line" deduction refers to a deduction *for* AGI.

   True False

5. Because they appear on page 1 of Form 1040, itemized deductions are also referred to as "page 1 deductions."

   True False

6. Most exclusions from gross income are not reported on Form 1040.

   True False

7. Once TI (taxable income) is determined, the taxpayer must make a choice between itemizing or claiming the standard deduction.

   True False

8. The filing status of a taxpayer (e.g., single, head of household) need not be identified until after taxable income is determined.

   True False

9. Lee, a citizen of Korea, is a resident of the U.S. Any income Lee receives from land he owns in Korea is subject to the U.S. income tax.

   True False

10. An increase in the amount of a taxpayer's AGI will not affect the amount of medical expenses allowed as a deduction.

    True False

11. Since an abandoned spouse is considered to be unmarried with dependents, the standard deduction for head of household can be used.

    True False

12. The additional standard deduction for age and blindness is the same amount for single as for married taxpayers.

    True False

13. The *basic* and *additional* standard deductions are subject to an annual adjustment for inflation.

    True False

14. A taxpayer who itemizes his deductions *from* AGI can claim the property taxes on his personal residence as a deduction.

    True False

15. It is possible for an individual taxpayer to claim more than one type of standard deduction.

    True False

16. Tad claims his 70-year-old mother as a dependent. The mother may *not* claim an additional standard deduction for her age.

    True False

17. In 2010, Ed is 66 and single. If he has itemized deductions of $6,200, he should claim the standard deduction alternative.

    True False

18. Jason and Peg are married and file a joint return. Both are over 65 years of age and Jason is blind. Their standard deduction for 2010 is $14,700 ($11,400 + $1,100 + $1,100 + $1,100).

    True False

19. Derek, age 46, is a surviving spouse. If he has itemized deductions of $11,600 for 2010, Derek *should not* claim the standard deduction.

    True False

20. Buddy and Hazel are ages 72 and 71 and file a joint return. If they have itemized deductions of $13,500 for 2010, they *should not* claim the standard deduction.

    True False

21. Clara, age 68, claims head of household filing status. If she has itemized deductions of $9,500 for 2010, she *should* claim the standard deduction.

    True False

22. Monique is a citizen of the U.S. and a resident of Canada. If she files a U.S. income tax return, Monique *can* claim the standard deduction.

    True False

23. Dan and Donna are husband and wife and file separate returns for the year. Even if Dan itemizes his deductions *from* AGI, Donna can still claim the standard deduction.

True False

24. Logan, an 80-year-old widower, dies on January 2, 2010. Even though he lived for only two days, on his final income tax return for 2010, the *full* basic and additional standard deductions can be claimed.

True False

25. Benjamin, age 16, is claimed as a dependent by his parents. During 2010, he earned $700 at a car wash. Benjamin's standard deduction is $1,250 ($950 + $300).

True False

26. Debby, age 18, is claimed as a dependent by her mother. During 2010, she earned $1,100 in interest income on a savings account. Debby's standard deduction is $1,400 ($1,100 + $300).

True False

27. Katrina, age 16, is claimed as a dependent by her parents. During 2010, she earned $5,500 as a checker at a grocery store. Her standard deduction is $5,800 ($5,500 earned income + $300).

True False

28. A dependent *cannot* claim a personal exemption on his or her own return.

True False

29. When separate income tax returns are filed by married taxpayers, one spouse *cannot* claim the other spouse as an exemption.

True False

30. Butch and Minerva are divorced in December of 2010. Since they were not married at the end of the year, they are considered *not* married for 2010.

True False

31. For the year a spouse dies, the surviving spouse is considered married for the entire year for income tax purposes.

True False

32. In determining whether the support test is met for dependency exemption purposes, only the taxable portion of a scholarship is considered.

True False

33. Albert buys his mother a used car. For purposes of meeting the support test, Albert cannot count the cost of the used car.

True False

34. Even if the individual does not spend funds that have been received from another source (e.g., interest on municipal bonds), the unexpended amounts are considered for purposes of the support test.

True False

35. Using borrowed funds from a mortgage on her home, Leah provides 52% of her own support, while her sons furnished the rest. Leah can be claimed as a dependent under a multiple support agreement.

True False

36. Roy and Linda were divorced in 2009. The divorce decree awards custody of their children to Linda but is silent as to who is entitled to claim them as dependents. If Roy furnished more than half of their support, he can claim them as dependents in 2010.

True False

37. In 2010, Hal furnishes more than half of the support of his ex-wife and her father, neither of whom lives with him. The divorce occurred in 2009. Hal may claim the father-in-law but not the ex-wife as dependents.

True False

38. After her divorce, Hope continues to support her ex-husband's sister, Cindy, who does not live with her. Hope *cannot* claim Cindy as a dependent.

True False

39. Darren, age 20 and not disabled, earns $4,500 during 2010. Darren's parents *cannot* claim him as a dependent unless he is a full-time student.

True False

40. Keith, age 17 and single, earns $4,000 during 2010. Keith's parents can claim him as a dependent even if he does not live with them.

True False

41. Sarah furnishes more than 50% of the support of her son and daughter-in-law who live with her. If the son and daughter-in-law file a joint return, Sarah *cannot* claim them as dependents.

True False

42. Kim, a resident of Oregon, supports his parents who are residents of Canada but citizens of Korea. Kim cannot claim his parents as dependents.

True False

43. Carolyn lives in New York and supports her niece who is a Canadian citizen that resides in Quebec, Canada. Carolyn *may* claim her niece as a dependent.

True False

44. Stealth taxes are directed at higher income taxpayers.

True False

45. The IRS facilitates the filing of income tax returns by persons in the U.S. illegally through the issuance of ITINs.

True False

46. An individual taxpayer uses a fiscal year February 1-January 31. The due date of this taxpayer's Federal income tax return is June 15 of each tax year.

True False

47. Surviving spouse filing status begins in the year in which the deceased spouse died.

True False

48. In January 2010, Jake's wife dies and he does not remarry. For tax year 2010, Jake may *not* be able to use the filing status available to married persons filing joint returns.

True False

49. For tax purposes, married persons filing separate returns are treated the same as single taxpayers.

True False

50. Katelyn is divorced and maintains a household in which she and her daughter, Crissa, live. Crissa, age 22, earns $11,000 during 2010 as a model. Katelyn does not qualify for head of household filing status.

True False

51. Ed is divorced and maintains a home in which he and a dependent friend live. Ed qualifies for head of household filing status.

True False

52. In terms of income tax consequences, abandoned spouses *are not* treated the same way as married persons filing separate returns.

True False

53. The kiddie tax does not apply as to a child whose earned income is more than one-half of his or her support.

True False

54. Once a child reaches age 19, the kiddie tax no longer applies.

True False

55. When the kiddie tax applies and the parents are divorced, the applicable parent (for determining the parental tax) is the one with the greater taxable income.

True False

56. When the kiddie tax applies, the child need *not* file an income tax return because the child's income will be reported on the parents' return.

True False

57. A child who has unearned income of $1,900 or less cannot be subject to the kiddie tax.

True False

58. A child who is married can be subject to the kiddie tax.

True False

59. In 2010, Warren sold his personal use automobile for a loss of $9,000. He also sold a personal coin collection for a gain of $10,000. As a result of these sales, $1,000 is subject to income tax.

True False

60. In some cases, the tax on long-term capital gains can be as low as 0%.

True False

61. Gain on the sale of collectibles held for more than 12 months is subject to tax at a rate no higher than 28%.

True False

62. For 2010, Stuart has a short-term capital loss, a collectible long-term capital gain, and a long-term capital gain from land held as investment. The short-term loss is first applied to the collectible capital gain.

True False

63. In terms of the tax formula applicable to individual taxpayers, which, if any, of the following statements is *correct*?

A. The formula does not apply if a taxpayer elects to claim the standard deduction.
B. In arriving at AGI, personal and dependency exemptions must be subtracted from gross income.
C. In arriving at taxable income, a taxpayer must choose between the standard deduction and claiming personal and dependency exemptions.
D. In arriving at taxable income, a taxpayer must choose between the standard deduction and deductions *for* AGI.
E. None of the above.

64. Regarding the tax formula and its relationship to Form 1040, which, if any, of the following statements is *correct*?

A. Most exclusions from gross income are reported on page 2 of Form 1040.
B. An "above the line deduction" refers to a deduction *for* AGI.
C. A "page 1 deduction" refers to a deduction *from* AGI.
D. The taxable income (TI) amount appears both at the bottom of page 1 and at the top of page 2 of Form 1040.
E. None of the above.

65. Which of the following items, if any, is deductible?

A. Parking expenses incurred in connection with jury duty—taxpayer is a dentist.
B. Contributions to mayor's reelection campaign.
C. Substantiated gambling losses (not in excess of gambling winnings) incurred on a vacation to Reno.
D. Speeding ticket incurred while on business.
E. Premiums paid on personal life insurance policy.

66. Which, if any, of the following is a deduction *from* AGI?

A. Alimony payments.
B. Child support payments.
C. Funeral expenses.
D. Loss on the sale of a personal residence.
E. Interest on home mortgage.

67. Which, if any, of the following is a deduction *for* AGI?

A. Alimony payments.
B. Interest on home mortgage.
C. Unreimbursed employee expenses.
D. Charitable contributions.
E. None of the above.

68. Which, if any, of the statements regarding the standard deduction is correct?

A. The basic standard deduction is indexed for inflation but the additional standard deduction is not.
B. Not available to taxpayers who choose to deduct their personal and dependency exemptions.
C. Not available to taxpayers who choose to claim their deduction *for* AGI.
D. Some taxpayers may qualify for two additional standard deductions.
E. None of the above.

69. Which, if any, of the following statements relating to the standard deduction is *correct*?

A. If a taxpayer dies during the year, his (or her) standard deduction must be prorated.
B. If spouses file separate returns, both spouses must claim the standard deduction (rather than itemize their deductions *from* AGI).
C. If a taxpayer is claimed as a dependent of another, his (or her) additional standard deduction is allowed in full (i.e., no adjustment is necessary).
D. If a taxpayer is claimed as a dependent of another, no basic standard deduction is allowed.
E. None of the above.

70. During 2010, Marvin had the following transactions:

Salary	$50,000
Bank loan (proceeds used to buy personal auto)	10,000
Alimony paid	6,000
Child support paid	12,000
Gift from aunt	20,000

Marvin's AGI is:

A. $32,000.
B. $38,000.
C. $44,000.
D. $56,000.
E. $64,000.

71. During 2010, Anna had the following transactions:

Salary	$70,000
Interest income on City of Denver bonds	2,000
Inheritance from uncle	40,000
Contribution to traditional IRA	5,000
Lottery losses	3,000

Anna's AGI is:

A. $62,000.
B. $65,000.
C. $67,000.
D. $102,000.
E. $104,000.

72. During 2010, Justin had the following transactions:

Salary	$ 80,000
Interest income on IBM bonds	2,000
Damages for personal injury (car accident)	200,000
Punitive damages (same car accident)	100,000
Cash dividends from Chevron Corporation stock	5,000

Justin's AGI is:

A. $185,000.
B. $187,000.
C. $285,000.
D. $287,000.
E. $385,000.

73. In 2010, Sylvia had the following transactions:

Salary	$90,000
Capital loss from a stock investment	(4,000)
Moving expense to change jobs	(11,000)
Received repayment of $20,000 loan she made to her brother in 2006 (includes interest of $2,000)	22,000
State income taxes	(5,000)

Sylvia's AGI is:

A. $73,000.
B. $77,000.
C. $78,000.
D. $81,000.
E. $89,000.

74. Merle, age 17, is claimed by her parents as a dependent. During 2010, she had interest income from a bank savings account of $2,000 and income from a part-time job of $4,200. Merle's taxable income is:

A. $4,200 – $4,500 = $0.
B. $6,200 – $5,700 = $500.
C. $6,200 – $4,500 = $1,700.
D. $6,200 – $950 = $5,250.
E. None of the above.

75. Tony, age 15, is claimed as a dependent by his grandmother. During 2010, Tony had interest income from Boeing Corporation bonds of $1,000 and earnings from a part-time job of $700. Tony's taxable income is:

A. $0.
B. $1,700 – $700 – $950 = $50.
C. $1,700 – $1,000 = $700.
D. $1,700 – $950 = $750.
E. None of the above.

76. Wilma is a widow, age 80 and blind, who is claimed as a dependent by her son. During 2010, she received $4,800 in Social Security benefits, $2,200 in bank interest, and $1,800 in cash dividends from stocks. Wilma's taxable income is:

A. $4,000 – $950 – $2,800 = $250.
B. $4,000 – $2,800 = $1,200.
C. $4,000 – $950 – $1,400 = $1,650.
D. $8,800 – $950 – $2,800 = $5,050.
E. None of the above.

77. Muriel, age 70 and single, is claimed as a dependent on her daughter's tax return. During 2010, she had interest income of $2,400 and $800 of earned income from baby sitting. Muriel's taxable income is:

A. $700.
B. $850.
C. $1,800.
D. $2,250.
E. None of the above.

78. Kyle and Liza are married and under 65 years of age. During 2010, they furnish more than half of the support of their 19-year old daughter, May, who lives with them. May earns $15,000 from a part-time job, most of which she sets aside for future college expenses. Kyle and Liza also provide more than half of the support of Kyle's cousin who lives with them. Liza's father, who died on January 3, 2010, at age 80, has for many years qualified as their dependent. How many personal and dependency exemptions should Kyle and Liza claim?

A. Two.
B. Three.
C. Four.
D. Five.
E. None of the above.

79. Evan and Eileen Carter are husband and wife and file a joint return for 2010. Both are under 65 years of age. They provide more than half of the support of their daughter, Pamela (age 25), who is a full-time medical student. Pamela receives a $5,000 scholarship covering her room and board at college. They furnish all of the support of Belinda (Evan's grandmother), who is age 70 and lives in a nursing home. They also support Peggy (age 66), who is a friend of the family and lives with them. How many personal and dependency exemptions may the Carters claim?

A. Two.
B. Three.
C. Four.
D. Five.
E. None of the above.

80. In which, if any, of the following situations may the individual *not* be claimed as a dependent of the taxpayer?

A. A former spouse who lives with the taxpayer (divorce took place last year).
B. A stepmother who does not live with the taxpayer.
C. A married daughter who lives with the taxpayer.
D. A half brother who does not live with the taxpayer and is a citizen and resident of Mexico.
E. A cousin who does not live with the taxpayer.

81. During 2010, Jen (age 66) furnished more than 50% of the support of the following persons:

· Jen's current husband who has no income and is not claimed by someone else as a dependent.
· Jen's stepson (age 18) who lives with her and earns $6,000 as a dance instructor. He dropped out of school a year ago.
· Jen's ex-husband who does not live with her. The divorce occurred two years ago.
· Jen's former brother-in-law who does not live with her.

Presuming all other dependency tests are met, on a *separate* return how many personal and dependency exemptions may Jen claim?

A. Two.
B. Three.
C. Four.
D. Five.
E. None of the above.

82. A qualifying child *cannot* include:

A. A nonresident alien.
B. A married son who files a joint return.
C. A daughter who is away at college.
D. A grandmother.
E. A brother who is 28 years of age and disabled.

83. Ellen, age 12, lives in the same household with her father, grandfather, and uncle. The cost of maintaining the household is provided by her grandfather (40%) and her uncle (60%). Disregarding tie-breaker rules, Ellen is a qualifying child as to:

A. All parties involved (i.e., father, grandfather, and uncle).
B. Only her grandfather and uncle.
C. Only her uncle.
D. Only her father.
E. None of the above.

84. Millie, age 80, is supported during the current year as follows:

	Percent of Support
Weston (a son)	10%
Faith (a daughter)	35%
Jake (a cousin)	35%
Brayden (unrelated close family friend)	20%

During the year, Millie lives in an assisted living facility. Under a multiple support agreement, indicate which parties can qualify to claim Millie as a dependent.

A. Weston, Faith, Jake, and Brayden.
B. Faith and Brayden.
C. Weston and Faith.
D. Faith, Jake, and Brayden.
E. None of the above.

85. The Hutters filed a joint return for 2010. They provide more than 50% of the support of Carla, Melvin, and Aaron. Carla (age 18) is a cousin and earns $5,000 from a part-time job. Melvin (age 25) is their son and is a full-time law student. He received from the university a $3,800 scholarship for tuition. Aaron is a brother who is a citizen of Israel but resides in France. Carla and Melvin live with the Hutters. How many personal and dependency exemptions can the Hutters claim on their Federal income tax return?

A. Two.
B. Three.
C. Four.
D. Five.
E. None of the above.

86. For the qualifying relative rule (for dependency exemption purposes):

A. The dependent must be under age 19 or a full-time student under age 24.
B. The dependent need not reside with the taxpayer claiming the exemption.
C. The dependent must be related to the taxpayer claiming the exemption.
D. The dependent must be a citizen or resident of the U.S.
E. None of the above.

87. Kyle, whose wife died in December 2007, filed a joint tax return for 2007. He did *not* remarry, but has continued to maintain his home in which his two dependent children live. What is Kyle's filing status as to 2010?

A. Head of household.
B. Surviving spouse.
C. Single.
D. Married filing separately.
E. None of the above.

88. Emily, whose husband died in December 2010, maintains a household in which her dependent daughter lives. Which (if any) of the following is her filing status for the tax year 2010? (Note: Emily is the executor of her husband's estate.)

A. Single.
B. Married, filing separately.
C. Surviving spouse.
D. Head of household.
E. Married, filing jointly.

89. Which of the following taxpayers may file as a head of household in 2010?

Ron provides all the support for his mother, Betty, who lives by herself in an apartment in Fort Lauderdale. Ron pays the rent and other expenses for the apartment and properly claims his mother as a dependent.

Tammy provides over one-half the support for her 18-year old brother, Dan. Dan earned $4,200 in 2010 working at a fast food restaurant and is saving his money to attend college in 2011. Dan lives in Tammy's home.

Joe's wife left him late in December of 2009. No legal action was taken and Joe has not heard from her in 2010. Joe supported his 6-year-old son, who lived with him throughout 2010.

A. Ron only.
B. Tammy only.
C. Joe only.
D. Ron and Joe only.
E. Ron, Tammy, and Joe.

90. Nelda is married to Chad, who abandoned her in early June of 2010. She has not seen or communicated with him since then. She maintains a household in which she and her two dependent children live. Which of the following statements about Nelda's filing status in 2010 is correct?

A. Nelda can use the rates for single taxpayers.
B. Nelda can file a joint return with Chad.
C. Nelda can file as a surviving spouse.
D. Nelda can file as a head of household.
E. None of the above statements is appropriate.

91. Arnold is married to Sybil, who abandoned him in 2008. He has not seen or communicated with her since April of that year. He maintains a household in which their son, Evans, lives. Evans is age 25 and earns over $20,000 each year. For tax year 2010, Arnold's filing status is:

A. Married, filing jointly.
B. Married, filing separately.
C. Head of household.
D. Surviving spouse.
E. Single.

92. In which, if any, of the following situations will the kiddie tax *not* apply?

A. The child has unearned income of less than $3,650.
B. The child is married but does not file a joint return.
C. The child has unearned income that exceeds more than half of his (or her) support.
D. The child is age 24 and a full-time student.
E. None of the above.

93. Which, if any, of the following is a correct statement relating to the kiddie tax?

A. The kiddie tax does not apply if both parents of the child are deceased.
B. The components for the application of the kiddie tax are not subject to adjustment for inflation.
C. If the kiddie tax applies, the parents must include the income of the child on their own income tax return.
D. If the parents are divorced, the income of the noncustodial parent is used to determine the allocable parental tax.
E. None of the above.

94. During the year, Kim sold the following assets: business auto for a $1,000 loss, stock investment for a $1,000 loss, and pleasure yacht for a $1,000 loss. Presuming adequate income, how much of these losses may Kim claim?

A. $0.
B. $1,000.
C. $2,000.
D. $3,000.
E. None of the above.

95. Perry is in the 33% tax bracket. During 2010, he had the following capital asset transactions:

Gain from the sale of a stamp collection (held for 10 years)	$30,000
Gain from the sale of an investment in land (held for 4 years)	10,000
Gain from the sale of stock investment (held for 8 months)	4,000

Perry’s tax consequences from these gains are as follows:

A. (15% ´ $10,000) + (28% ´ $30,000) + (33% ´ $4,000).
B. (15% ´ $30,000) + (33% ´ $4,000).
C. (0% ´ $10,000) + (28% ´ $30,000) + (33% ´ $4,000).
D. (15% ´ $40,000) + (33% ´ $4,000).
E. None of the above.

96. Kirby is in the 15% tax bracket and had the following capital asset transactions during 2010:

Long-term gain from the sale of a coin collection	$11,000
Long-term gain from the sale of a land investment	10,000
Short-term gain from the sale of a stock investment	2,000

Kirby’s tax consequences from these gains are as follows:

A. (5% ´ $10,000) + (15% ´ $13,000).
B. (0% ´ $10,000) + (15% ´ $13,000).
C. (15% ´ $13,000) + (28% ´ $11,000).
D. (15% ´ $23,000).
E. None of the above.

97. For the current year, David has salary income of $80,000 and the following property transactions:

Stock investment sales—	
Long-term capital gain	$ 9,000
Short-term capital loss	(11,000)
Loss on sale of camper (purchased 4 years ago and used for family vacations)	(2,000)

What is David's AGI for the current year?

A. $76,000.
B. $77,000.
C. $78,000.
D. $89,000.
E. None of the above.

98. During 2010, Trevor has the following capital transactions:

LTCG	$ 6,000
Long-term collectible gain	2,000
STCG	4,000
STCL	10,000

After the netting process, the following results:

A. Long-term collectible gain of $2,000.
B. LTCG of $6,000, Long-term collectible gain of $2,000, and a STCL of $6,000.
C. LTCG of $6,000, Long-term collectible gain of $2,000, and a STCL carryover to 2011 of $3,000.
D. LTCG of $2,000.
E. None of the above.

99. Emma had the following transactions during 2010:

Salary		$70,000
Interest income on bonds—		
Issued by City of Newark	$3,000	
Issued by Chevron Corporation	2,000	5,000
Alimony received		4,000
Child support received		12,000
City and state income taxes paid		5,000
Bank loan obtained to pay for vacation		8,000

What is Emma's AGI for 2010?

100. Robert had the following transactions for 2010:

Salary		$ 80,000
Alimony paid		6,000
Recovery from car accident—		
Personal injury damages	$60,000	
Punitive damages	30,000	90,000
Gift from parents		26,000
Property sales—		
Loss on sale of camper (used for pleasure and owned 3 years)	($ 2,000)	
Gain on sale of Conoco stock (held for 8 months as an investment)	3,000	1,000

What is Robert's AGI for 2010?

101. Karen had the following transactions for 2010:

Salary	$ 90,000
Moving expenses incurred to change jobs	8,000
Inheritance received from deceased uncle	300,000
Life insurance proceeds from policy on uncle's life (Karen was named the beneficiary)	200,000
Cash prize from church raffle	1,000
Payment of church pledge	3,000

What is Karen's AGI for 2010?

102. Gene is single and for 2010 has AGI of $40,000. He is age 65 and has no dependents. For 2010, he has itemized deductions *from* AGI of $7,000. Determine Gene's taxable income for 2010.

103. Warren, age 17, is claimed as a dependent by his father. In 2010, Warren has dividend income of $1,500 and earns $400 from a part-time job.

a. What is Warren's taxable income for 2010?
b. Suppose Warren earned $1,200 (not $400) from the part-time job. What is Warren's taxable income for 2010?

104. Meg, age 23, is a full-time law student and is claimed by her parents as a dependent. During 2010, she received $1,400 interest income from a bank savings account and $5,600 from a part-time job. What is Meg's taxable income for 2010?

105. Heloise, age 74 and a widow, is claimed as a dependent by her daughter. For 2010, she had income as follows: $2,500 interest on municipal bonds; $3,200 Social Security benefits; $3,000 income from a part-time job; and $2,800 dividends on stock investments. What is Heloise's taxable income for 2010?

106. Pablo is married to Elena, who lives with him. Both are U.S. citizens and residents of Kansas. Pablo furnishes all of the support of his parents, who are citizens of Nicaragua and residents of Mexico. He also furnishes all of the support of Elena's parents, who are citizens and residents of Nicaragua. Elena has no gross income for the year. If Pablo files as a married person filing separately, how many personal and dependency exemptions can he claim on his return?

107. Homer (age 68) and his wife Jean (age 70) file a joint return. They furnish all of the support of Luther (Homer's 90-year old father), who lives with them. For 2010, they received $6,000 of interest income on city of Chicago bonds and interest income on corporate bonds of $48,000. Compute Homer and Jean's taxable income for 2010.

108. Ellen, age 39 and single, furnishes more than 50% of the support of her parents, who do not live with her. Ellen practices as a self-employed interior decorator and has gross income in 2010 of $120,000. Her deductions are as follows: $30,000 business and $8,100 itemized.

a. What is Ellen's taxable income for 2010?
b. Can Ellen qualify for head of household filing status? Explain.

109. Ashley earns a salary of $35,000, has capital gains of $4,000, and interest income of $3,000 in 2010. Her husband died in 2009. Ashley has a dependent son, Tyrone, who is age 8. Her itemized deductions are $9,000.

a. Calculate Ashley's taxable income for 2010.
b. What is her filing status?

110. During the year, Marcus had the following transactions:

Long-term loss on the sale of business use equipment	$6,000
Long-term loss on the sale of personal use camper	2,000
Long-term gain on the sale of personal use boat	1,000
Short-term loss on the sale of stock investment	3,000
Long-term loss on the sale of land investment	4,000

How are these transactions handled for income tax purposes?

111. During 2010, Dena has the following gains and losses:

LTCG	$4,000
LTCL	1,000
STCG	500
STCL	3,000

a. How much is Dena's tax liability if she is in the 15% tax bracket?
b. If her tax bracket is 33% (not 15%)?

112.During 2010, Marlo had the following capital gains and losses:

Gain from the sale of coin collection (held three years)	$5,000
Gain from the sale of land held as an investment for six years	4,000
Gain from the sale of stock held as an investment (held for 10 months)	1,000

a. How much is Marlo's tax liability if he is in the 15% tax bracket?
b. If his tax bracket is 33% (not 15%)?

113.During 2010, Carmen had salary income of $90,000 and the following capital transactions:

LTCG	$4,000
LTCL	5,000
STCG	4,000
STCL	2,000

How are these transactions handled for income tax purposes?

114.Mr. Lee is a citizen and resident of Hong Kong, while Mr. Anderson is a citizen and resident of the U.S. In the taxation of income, Hong Kong uses a territorial approach, while the U.S. follows the global system. In terms of effect, explain what this means to Mr. Lee and Mr. Anderson.

115. During the current year, Doris received a large gift from her parents and a sizeable inheritance from an uncle. She also paid premiums on an insurance policy on her life. Doris is confused because she cannot find any place on Form 1040 to report these items. Explain.

116. Mel is not quite sure whether an expenditure he made is a deduction *for* AGI or a deduction *from* AGI. Since he plans to choose the standard deduction option for the year, does the distinction matter? Explain.

117. In satisfying the support test and the gross income test for claiming a dependency exemption, a scholarship received by the person being claimed is handled the same way for each test. Do you agree or disagree with this statement? Why?

118. In order to claim a dependency exemption for other than a qualifying child, a taxpayer must meet the support test. Generally, this is done by furnishing more than 50% of a dependent's support. What exceptions exist, if any, where the support furnished need not be more than 50%?

119. In applying the gross income test in the case of dependents that are married, could the application of community property laws have any effect? Explain.

120. In meeting the criteria of a qualifying child for dependency exemption purposes, when if ever, might the child's income become relevant?

121. Mickey, age 12, lives in the same household with his mother, grandmother, and uncle.

a. Under the qualifying child rules, which of these family members can claim Mickey as a dependent? Who would prevail?

b. Suppose the mother has no income and does not even file a return.

122. What is a “stealth tax?”

123. Contrast the tax consequences resulting from the following filing status situations:

a. Married filing jointly versus married filing separately.
b. Married filing separately versus single filing separately.
c. Married filing separately versus abandoned spouse status.

124. Regarding head of household filing status, comment on the following:

a. A taxpayer qualifies even though he maintains a household which he and the dependent *do not* share.
b. A taxpayer does not qualify even though the person sharing the household *is* a dependent.
c. The usual eventual filing status of a surviving spouse.

125. The major advantage of being classified as an abandoned spouse is that the taxpayer is treated for tax purposes as being single and not married. This means that an abandoned spouse can use the more favorable tax rates available to single persons than those available to married persons filing separately. Comment on the accuracy of this conclusion.

126. For the past few years, Corey’s filing status has been as follows: 2006 (married/joint); 2007 (married/separate); 2008 (surviving spouse); 2009 (surviving spouse); and 2010 (head of household). Explain what probably has happened.

127. DeWayne is a U.S. citizen and resident. He spends much of each year in the United Kingdom on business. He is married to Petula, a U.K. citizen and resident of London. DeWayne has heard that it is possible that he can file a joint income tax return for U.S. purposes. If this is so, what are the constraints he should consider in making any such decision?

128. List at least three exceptions to the application of the kiddie tax.

129. The Martins have a teenage son who has become an accomplished bagpiper. With proper promotion and scheduling, the son has good income potential by charging for his services at special events (particularly funerals). However, the Martins are fearful that the income could generate a kiddie tax and cause them the loss of a dependency exemption deduction. Are the Martins' concerns justified? Explain.

130. In early 2010, Ben sold a yacht, held for 9 months and for pleasure, for a $5,000 gain. Concerned about offsetting the gain before year-end, Ben is considering selling one of the following—each of which would yield a $5,000 loss:

- Houseboat used for recreation.
- Truck used in business.
- Stock investment held for 13 months.

Evaluate each choice.

131. After paying down the mortgage on their personal residence, the Hills have found that their itemized deductions for each year are always slightly less than the standard deduction option.

a. Explain what has happened.
b. What remedy do you suggest?

132. Maude's parents live in another state and she cannot claim them as her dependents. If Maude pays their medical expenses, can she derive any tax benefit from doing so? Explain.

CHAPTER 3--TAX FORMULA AND TAX DETERMINATION; AN OVERVIEW OF PROPERTY TRANSACTIONS Key

1. Currently, the *top* Federal income tax rate in effect is the highest it has ever been.

   FALSE

2. As used in the income tax formula, *gross income* would not include the receipt of a loan the taxpayer obtained from a bank.

   TRUE

3. Under the income tax formula, a taxpayer must choose between deductions *for* AGI and the standard deduction.

   FALSE

4. An "above the line" deduction refers to a deduction *for* AGI.

   TRUE

5. Because they appear on page 1 of Form 1040, itemized deductions are also referred to as "page 1 deductions."

   FALSE

6. Most exclusions from gross income are not reported on Form 1040.

   TRUE

7. Once TI (taxable income) is determined, the taxpayer must make a choice between itemizing or claiming the standard deduction.

   FALSE

8. The filing status of a taxpayer (e.g., single, head of household) need not be identified until after taxable income is determined.

   FALSE

9. Lee, a citizen of Korea, is a resident of the U.S. Any income Lee receives from land he owns in Korea is subject to the U.S. income tax.

   TRUE

10. An increase in the amount of a taxpayer's AGI will not affect the amount of medical expenses allowed as a deduction.

    FALSE

11. Since an abandoned spouse is considered to be unmarried with dependents, the standard deduction for head of household can be used.

TRUE

12. The additional standard deduction for age and blindness is the same amount for single as for married taxpayers.

FALSE

13. The *basic* and *additional* standard deductions are subject to an annual adjustment for inflation.

TRUE

14. A taxpayer who itemizes his deductions *from* AGI can claim the property taxes on his personal residence as a deduction.

TRUE

15. It is possible for an individual taxpayer to claim more than one type of standard deduction.

TRUE

16. Tad claims his 70-year-old mother as a dependent. The mother may *not* claim an additional standard deduction for her age.

FALSE

17. In 2010, Ed is 66 and single. If he has itemized deductions of $6,200, he should claim the standard deduction alternative.

TRUE

18. Jason and Peg are married and file a joint return. Both are over 65 years of age and Jason is blind. Their standard deduction for 2010 is $14,700 ($11,400 + $1,100 + $1,100 + $1,100).

TRUE

19. Derek, age 46, is a surviving spouse. If he has itemized deductions of $11,600 for 2010, Derek *should not* claim the standard deduction.

TRUE

20. Buddy and Hazel are ages 72 and 71 and file a joint return. If they have itemized deductions of $13,500 for 2010, they *should not* claim the standard deduction.

FALSE

21. Clara, age 68, claims head of household filing status. If she has itemized deductions of $9,500 for 2010, she *should* claim the standard deduction.

TRUE

22. Monique is a citizen of the U.S. and a resident of Canada. If she files a U.S. income tax return, Monique *can* claim the standard deduction.

TRUE

23. Dan and Donna are husband and wife and file separate returns for the year. Even if Dan itemizes his deductions *from* AGI, Donna can still claim the standard deduction.

FALSE

24. Logan, an 80-year-old widower, dies on January 2, 2010. Even though he lived for only two days, on his final income tax return for 2010, the *full* basic and additional standard deductions can be claimed.

TRUE

25. Benjamin, age 16, is claimed as a dependent by his parents. During 2010, he earned $700 at a car wash. Benjamin's standard deduction is $1,250 ($950 + $300).

FALSE

26. Debby, age 18, is claimed as a dependent by her mother. During 2010, she earned $1,100 in interest income on a savings account. Debby's standard deduction is $1,400 ($1,100 + $300).

FALSE

27. Katrina, age 16, is claimed as a dependent by her parents. During 2010, she earned $5,500 as a checker at a grocery store. Her standard deduction is $5,800 ($5,500 earned income + $300).

FALSE

28. A dependent *cannot* claim a personal exemption on his or her own return.

TRUE

29. When separate income tax returns are filed by married taxpayers, one spouse *cannot* claim the other spouse as an exemption.

FALSE

30. Butch and Minerva are divorced in December of 2010. Since they were not married at the end of the year, they are considered *not* married for 2010.

TRUE

31. For the year a spouse dies, the surviving spouse is considered married for the entire year for income tax purposes.

TRUE

32. In determining whether the support test is met for dependency exemption purposes, only the taxable portion of a scholarship is considered.

FALSE

33. Albert buys his mother a used car. For purposes of meeting the support test, Albert cannot count the cost of the used car.

FALSE

34. Even if the individual does not spend funds that have been received from another source (e.g., interest on municipal bonds), the unexpended amounts are considered for purposes of the support test.

FALSE

35. Using borrowed funds from a mortgage on her home, Leah provides 52% of her own support, while her sons furnished the rest. Leah can be claimed as a dependent under a multiple support agreement.

FALSE

36. Roy and Linda were divorced in 2009. The divorce decree awards custody of their children to Linda but is silent as to who is entitled to claim them as dependents. If Roy furnished more than half of their support, he can claim them as dependents in 2010.

FALSE

37. In 2010, Hal furnishes more than half of the support of his ex-wife and her father, neither of whom lives with him. The divorce occurred in 2009. Hal may claim the father-in-law but not the ex-wife as dependents.

TRUE

38. After her divorce, Hope continues to support her ex-husband's sister, Cindy, who does not live with her. Hope *cannot* claim Cindy as a dependent.

FALSE

39. Darren, age 20 and not disabled, earns $4,500 during 2010. Darren's parents *cannot* claim him as a dependent unless he is a full-time student.

TRUE

40. Keith, age 17 and single, earns $4,000 during 2010. Keith's parents can claim him as a dependent even if he does not live with them.

FALSE

41. Sarah furnishes more than 50% of the support of her son and daughter-in-law who live with her. If the son and daughter-in-law file a joint return, Sarah *cannot* claim them as dependents.

FALSE

42. Kim, a resident of Oregon, supports his parents who are residents of Canada but citizens of Korea. Kim cannot claim his parents as dependents.

FALSE

43. Carolyn lives in New York and supports her niece who is a Canadian citizen that resides in Quebec, Canada. Carolyn *may* claim her niece as a dependent.

TRUE

44. Stealth taxes are directed at higher income taxpayers.

TRUE

45. The IRS facilitates the filing of income tax returns by persons in the U.S. illegally through the issuance of ITINs.

<u>TRUE</u>

46. An individual taxpayer uses a fiscal year February 1-January 31. The due date of this taxpayer's Federal income tax return is June 15 of each tax year.

<u>FALSE</u>

47. Surviving spouse filing status begins in the year in which the deceased spouse died.

<u>FALSE</u>

48. In January 2010, Jake's wife dies and he does not remarry. For tax year 2010, Jake may *not* be able to use the filing status available to married persons filing joint returns.

<u>TRUE</u>

49. For tax purposes, married persons filing separate returns are treated the same as single taxpayers.

<u>FALSE</u>

50. Katelyn is divorced and maintains a household in which she and her daughter, Crissa, live. Crissa, age 22, earns $11,000 during 2010 as a model. Katelyn does not qualify for head of household filing status.

<u>TRUE</u>

51. Ed is divorced and maintains a home in which he and a dependent friend live. Ed qualifies for head of household filing status.

<u>FALSE</u>

52. In terms of income tax consequences, abandoned spouses *are not* treated the same way as married persons filing separate returns.

<u>TRUE</u>

53. The kiddie tax does not apply as to a child whose earned income is more than one-half of his or her support.

<u>TRUE</u>

54. Once a child reaches age 19, the kiddie tax no longer applies.

<u>FALSE</u>

55. When the kiddie tax applies and the parents are divorced, the applicable parent (for determining the parental tax) is the one with the greater taxable income.

<u>FALSE</u>

56. When the kiddie tax applies, the child need *not* file an income tax return because the child's income will be reported on the parents' return.

<u>FALSE</u>

57. A child who has unearned income of $1,900 or less cannot be subject to the kiddie tax.

TRUE

58. A child who is married can be subject to the kiddie tax.

TRUE

59. In 2010, Warren sold his personal use automobile for a loss of $9,000. He also sold a personal coin collection for a gain of $10,000. As a result of these sales, $1,000 is subject to income tax.

FALSE

60. In some cases, the tax on long-term capital gains can be as low as 0%.

TRUE

61. Gain on the sale of collectibles held for more than 12 months is subject to tax at a rate no higher than 28%.

TRUE

62. For 2010, Stuart has a short-term capital loss, a collectible long-term capital gain, and a long-term capital gain from land held as investment. The short-term loss is first applied to the collectible capital gain.

TRUE

63. In terms of the tax formula applicable to individual taxpayers, which, if any, of the following statements is *correct*?

A. The formula does not apply if a taxpayer elects to claim the standard deduction.
B. In arriving at AGI, personal and dependency exemptions must be subtracted from gross income.
C. In arriving at taxable income, a taxpayer must choose between the standard deduction and claiming personal and dependency exemptions.
D. In arriving at taxable income, a taxpayer must choose between the standard deduction and deductions *for* AGI.
E. None of the above.

64. Regarding the tax formula and its relationship to Form 1040, which, if any, of the following statements is *correct*?

A. Most exclusions from gross income are reported on page 2 of Form 1040.
B. An “above the line deduction” refers to a deduction *for* AGI.
C. A “page 1 deduction” refers to a deduction *from* AGI.
D. The taxable income (TI) amount appears both at the bottom of page 1 and at the top of page 2 of Form 1040.
E. None of the above.

65. Which of the following items, if any, is deductible?

A. Parking expenses incurred in connection with jury duty—taxpayer is a dentist.
B. Contributions to mayor’s reelection campaign.
C. Substantiated gambling losses (not in excess of gambling winnings) incurred on a vacation to Reno.
D. Speeding ticket incurred while on business.
E. Premiums paid on personal life insurance policy.

66. Which, if any, of the following is a deduction *from* AGI?

A. Alimony payments.
B. Child support payments.
C. Funeral expenses.
D. Loss on the sale of a personal residence.
E. Interest on home mortgage.

67. Which, if any, of the following is a deduction *for* AGI?

A. Alimony payments.
B. Interest on home mortgage.
C. Unreimbursed employee expenses.
D. Charitable contributions.
E. None of the above.

68. Which, if any, of the statements regarding the standard deduction is correct?

A. The basic standard deduction is indexed for inflation but the additional standard deduction is not.
B. Not available to taxpayers who choose to deduct their personal and dependency exemptions.
C. Not available to taxpayers who choose to claim their deduction *for* AGI.
D. Some taxpayers may qualify for two additional standard deductions.
E. None of the above.

69. Which, if any, of the following statements relating to the standard deduction is *correct*?

A. If a taxpayer dies during the year, his (or her) standard deduction must be prorated.
B. If spouses file separate returns, both spouses must claim the standard deduction (rather than itemize their deductions *from* AGI).
C. If a taxpayer is claimed as a dependent of another, his (or her) additional standard deduction is allowed in full (i.e., no adjustment is necessary).
D. If a taxpayer is claimed as a dependent of another, no basic standard deduction is allowed.
E. None of the above.

70. During 2010, Marvin had the following transactions:

Salary	$50,000
Bank loan (proceeds used to buy personal auto)	10,000
Alimony paid	6,000
Child support paid	12,000
Gift from aunt	20,000

Marvin's AGI is:

A. $32,000.
B. $38,000.
C. $44,000.
D. $56,000.
E. $64,000.

71. During 2010, Anna had the following transactions:

Salary	$70,000
Interest income on City of Denver bonds	2,000
Inheritance from uncle	40,000
Contribution to traditional IRA	5,000
Lottery losses	3,000

Anna's AGI is:

A. $62,000.
B. $65,000.
C. $67,000.
D. $102,000.
E. $104,000.

72. During 2010, Justin had the following transactions:

Salary	$ 80,000
Interest income on IBM bonds	2,000
Damages for personal injury (car accident)	200,000
Punitive damages (same car accident)	100,000
Cash dividends from Chevron Corporation stock	5,000

Justin's AGI is:

A. $185,000.
B. $187,000.
C. $285,000.
D. $287,000.
E. $385,000.

73. In 2010, Sylvia had the following transactions:

Salary	$90,000
Capital loss from a stock investment	(4,000)
Moving expense to change jobs	(11,000)
Received repayment of $20,000 loan she made to her brother in 2006 (includes interest of $2,000)	22,000
State income taxes	(5,000)

Sylvia's AGI is:

A. $73,000.
B. $77,000.
C. $78,000.
D. $81,000.
E. $89,000.

74. Merle, age 17, is claimed by her parents as a dependent. During 2010, she had interest income from a bank savings account of $2,000 and income from a part-time job of $4,200. Merle's taxable income is:

A. $4,200 – $4,500 = $0.
B. $6,200 – $5,700 = $500.
C. $6,200 – $4,500 = $1,700.
D. $6,200 – $950 = $5,250.
E. None of the above.

75. Tony, age 15, is claimed as a dependent by his grandmother. During 2010, Tony had interest income from Boeing Corporation bonds of $1,000 and earnings from a part-time job of $700. Tony’s taxable income is:

A. $0.
B. $1,700 – $700 – $950 = $50.
C. $1,700 – $1,000 = $700.
D. $1,700 – $950 = $750.
E. None of the above.

76. Wilma is a widow, age 80 and blind, who is claimed as a dependent by her son. During 2010, she received $4,800 in Social Security benefits, $2,200 in bank interest, and $1,800 in cash dividends from stocks. Wilma’s taxable income is:

A. $4,000 – $950 – $2,800 = $250.
B. $4,000 – $2,800 = $1,200.
C. $4,000 – $950 – $1,400 = $1,650.
D. $8,800 – $950 – $2,800 = $5,050.
E. None of the above.

77. Muriel, age 70 and single, is claimed as a dependent on her daughter’s tax return. During 2010, she had interest income of $2,400 and $800 of earned income from baby sitting. Muriel’s taxable income is:

A. $700.
B. $850.
C. $1,800.
D. $2,250.
E. None of the above.

78. Kyle and Liza are married and under 65 years of age. During 2010, they furnish more than half of the support of their 19-year old daughter, May, who lives with them. May earns $15,000 from a part-time job, most of which she sets aside for future college expenses. Kyle and Liza also provide more than half of the support of Kyle’s cousin who lives with them. Liza’s father, who died on January 3, 2010, at age 80, has for many years qualified as their dependent. How many personal and dependency exemptions should Kyle and Liza claim?

A. Two.
B. Three.
C. Four.
D. Five.
E. None of the above.

79. Evan and Eileen Carter are husband and wife and file a joint return for 2010. Both are under 65 years of age. They provide more than half of the support of their daughter, Pamela (age 25), who is a full-time medical student. Pamela receives a $5,000 scholarship covering her room and board at college. They furnish all of the support of Belinda (Evan’s grandmother), who is age 70 and lives in a nursing home. They also support Peggy (age 66), who is a friend of the family and lives with them. How many personal and dependency exemptions may the Carters claim?

A. Two.
B. Three.
C. Four.
D. Five.
E. None of the above.

80. In which, if any, of the following situations may the individual *not* be claimed as a dependent of the taxpayer?

A. A former spouse who lives with the taxpayer (divorce took place last year).
B. A stepmother who does not live with the taxpayer.
C. A married daughter who lives with the taxpayer.
D. A half brother who does not live with the taxpayer and is a citizen and resident of Mexico.
E. A cousin who does not live with the taxpayer.

81. During 2010, Jen (age 66) furnished more than 50% of the support of the following persons:

- Jen's current husband who has no income and is not claimed by someone else as a dependent.
- Jen's stepson (age 18) who lives with her and earns $6,000 as a dance instructor. He dropped out of school a year ago.
- Jen's ex-husband who does not live with her. The divorce occurred two years ago.
- Jen's former brother-in-law who does not live with her.

Presuming all other dependency tests are met, on a *separate* return how many personal and dependency exemptions may Jen claim?

A. Two.
B. Three.
C. Four.
D. Five.
E. None of the above.

82. A qualifying child *cannot* include:

A. A nonresident alien.
B. A married son who files a joint return.
C. A daughter who is away at college.
D. A grandmother.
E. A brother who is 28 years of age and disabled.

83. Ellen, age 12, lives in the same household with her father, grandfather, and uncle. The cost of maintaining the household is provided by her grandfather (40%) and her uncle (60%). Disregarding tie-breaker rules, Ellen is a qualifying child as to:

A. All parties involved (i.e., father, grandfather, and uncle).
B. Only her grandfather and uncle.
C. Only her uncle.
D. Only her father.
E. None of the above.

84. Millie, age 80, is supported during the current year as follows:

	Percent of Support
Weston (a son)	10%
Faith (a daughter)	35%
Jake (a cousin)	35%
Brayden (unrelated close family friend)	20%

During the year, Millie lives in an assisted living facility. Under a multiple support agreement, indicate which parties can qualify to claim Millie as a dependent.

A. Weston, Faith, Jake, and Brayden.
B. Faith and Brayden.
C. Weston and Faith.
D. Faith, Jake, and Brayden.
E. None of the above.

85. The Hutters filed a joint return for 2010. They provide more than 50% of the support of Carla, Melvin, and Aaron. Carla (age 18) is a cousin and earns $5,000 from a part-time job. Melvin (age 25) is their son and is a full-time law student. He received from the university a $3,800 scholarship for tuition. Aaron is a brother who is a citizen of Israel but resides in France. Carla and Melvin live with the Hutters. How many personal and dependency exemptions can the Hutters claim on their Federal income tax return?

A. Two.
<u>B.</u> Three.
C. Four.
D. Five.
E. None of the above.

86. For the qualifying relative rule (for dependency exemption purposes):

A. The dependent must be under age 19 or a full-time student under age 24.
<u>B.</u> The dependent need not reside with the taxpayer claiming the exemption.
C. The dependent must be related to the taxpayer claiming the exemption.
D. The dependent must be a citizen or resident of the U.S.
E. None of the above.

87. Kyle, whose wife died in December 2007, filed a joint tax return for 2007. He did *not* remarry, but has continued to maintain his home in which his two dependent children live. What is Kyle's filing status as to 2010?

<u>A.</u> Head of household.
B. Surviving spouse.
C. Single.
D. Married filing separately.
E. None of the above.

88. Emily, whose husband died in December 2010, maintains a household in which her dependent daughter lives. Which (if any) of the following is her filing status for the tax year 2010? (Note: Emily is the executor of her husband's estate.)

A. Single.
B. Married, filing separately.
C. Surviving spouse.
D. Head of household.
<u>E.</u> Married, filing jointly.

89. Which of the following taxpayers may file as a head of household in 2010?

Ron provides all the support for his mother, Betty, who lives by herself in an apartment in Fort Lauderdale. Ron pays the rent and other expenses for the apartment and properly claims his mother as a dependent.

Tammy provides over one-half the support for her 18-year old brother, Dan. Dan earned $4,200 in 2010 working at a fast food restaurant and is saving his money to attend college in 2011. Dan lives in Tammy's home.

Joe's wife left him late in December of 2009. No legal action was taken and Joe has not heard from her in 2010. Joe supported his 6-year-old son, who lived with him throughout 2010.

A. Ron only.
B. Tammy only.
C. Joe only.
D. Ron and Joe only.
<u>E.</u> Ron, Tammy, and Joe.

90. Nelda is married to Chad, who abandoned her in early June of 2010. She has not seen or communicated with him since then. She maintains a household in which she and her two dependent children live. Which of the following statements about Nelda's filing status in 2010 is correct?

A. Nelda can use the rates for single taxpayers.
B. Nelda can file a joint return with Chad.
C. Nelda can file as a surviving spouse.
D. Nelda can file as a head of household.
E. None of the above statements is appropriate.

91. Arnold is married to Sybil, who abandoned him in 2008. He has not seen or communicated with her since April of that year. He maintains a household in which their son, Evans, lives. Evans is age 25 and earns over $20,000 each year. For tax year 2010, Arnold's filing status is:

A. Married, filing jointly.
B. Married, filing separately.
C. Head of household.
D. Surviving spouse.
E. Single.

92. In which, if any, of the following situations will the kiddie tax *not* apply?

A. The child has unearned income of less than $3,650.
B. The child is married but does not file a joint return.
C. The child has unearned income that exceeds more than half of his (or her) support.
D. The child is age 24 and a full-time student.
E. None of the above.

93. Which, if any, of the following is a correct statement relating to the kiddie tax?

A. The kiddie tax does not apply if both parents of the child are deceased.
B. The components for the application of the kiddie tax are not subject to adjustment for inflation.
C. If the kiddie tax applies, the parents must include the income of the child on their own income tax return.
D. If the parents are divorced, the income of the noncustodial parent is used to determine the allocable parental tax.
E. None of the above.

94. During the year, Kim sold the following assets: business auto for a $1,000 loss, stock investment for a $1,000 loss, and pleasure yacht for a $1,000 loss. Presuming adequate income, how much of these losses may Kim claim?

A. $0.
B. $1,000.
C. $2,000.
D. $3,000.
E. None of the above.

95. Perry is in the 33% tax bracket. During 2010, he had the following capital asset transactions:

Gain from the sale of a stamp collection (held for 10 years)	$30,000
Gain from the sale of an investment in land (held for 4 years)	10,000
Gain from the sale of stock investment (held for 8 months)	4,000

Perry's tax consequences from these gains are as follows:

A. (15% ´ $10,000) + (28% ´ $30,000) + (33% ´ $4,000).
B. (15% ´ $30,000) + (33% ´ $4,000).
C. (0% ´ $10,000) + (28% ´ $30,000) + (33% ´ $4,000).
D. (15% ´ $40,000) + (33% ´ $4,000).
E. None of the above.

96. Kirby is in the 15% tax bracket and had the following capital asset transactions during 2010:

Long-term gain from the sale of a coin collection	$11,000
Long-term gain from the sale of a land investment	10,000
Short-term gain from the sale of a stock investment	2,000

Kirby's tax consequences from these gains are as follows:

A. (5% ´ $10,000) + (15% ´ $13,000).
B. (0% ´ $10,000) + (15% ´ $13,000).
C. (15% ´ $13,000) + (28% ´ $11,000).
D. (15% ´ $23,000).
E. None of the above.

97. For the current year, David has salary income of $80,000 and the following property transactions:

Stock investment sales—	
Long-term capital gain	$ 9,000
Short-term capital loss	(11,000)
Loss on sale of camper (purchased 4 years ago and used for family vacations)	(2,000)

What is David's AGI for the current year?

A. $76,000.
B. $77,000.
C. $78,000.
D. $89,000.
E. None of the above.

98. During 2010, Trevor has the following capital transactions:

LTCG	$ 6,000
Long-term collectible gain	2,000
STCG	4,000
STCL	10,000

After the netting process, the following results:

A. Long-term collectible gain of $2,000.
B. LTCG of $6,000, Long-term collectible gain of $2,000, and a STCL of $6,000.
C. LTCG of $6,000, Long-term collectible gain of $2,000, and a STCL carryover to 2011 of $3,000.
D. LTCG of $2,000.
E. None of the above.

99. Emma had the following transactions during 2010:

Salary		$70,000
Interest income on bonds—		
Issued by City of Newark	$3,000	
Issued by Chevron Corporation	2,000	5,000
Alimony received		4,000
Child support received		12,000
City and state income taxes paid		5,000
Bank loan obtained to pay for vacation		8,000

What is Emma's AGI for 2010?

$76,000. $70,000 (salary) + $2,000 (interest on Chevron Corporation bonds) + $4,000 (alimony received). Interest on the City of Newark bonds and the child support payments are exclusions from gross income. The bank loan has no tax effect, as Emma is obligated to repay the amount borrowed. City and state income taxes are deductions *from* AGI.

100. Robert had the following transactions for 2010:

Salary		$ 80,000
Alimony paid		6,000
Recovery from car accident—		
Personal injury damages	$60,000	
Punitive damages	30,000	90,000
Gift from parents		26,000
Property sales—		
Loss on sale of camper (used for pleasure and owned 3 years)	($ 2,000)	
Gain on sale of Conoco stock (held for 8 months as an investment)	3,000	1,000

What is Robert's AGI for 2010?

$107,000. $80,000 (salary) – $6,000 (alimony paid) + $30,000 (punitive damage award) + $3,000 (short-term capital gain on the sale of stock investment). The personal injury recovery and the gift from Robert's parents are exclusions from gross income. The loss from the sale of the camper is personal and, therefore, nondeductible. The short-term capital gain on the sale of the Conoco stock is taxed in full as ordinary income.

101. Karen had the following transactions for 2010:

Salary	$ 90,000
Moving expenses incurred to change jobs	8,000
Inheritance received from deceased uncle	300,000
Life insurance proceeds from policy on uncle's life (Karen was named the beneficiary)	200,000
Cash prize from church raffle	1,000
Payment of church pledge	3,000

What is Karen's AGI for 2010?

$83,000. $90,000 (salary) + $1,000 (raffle prize) – $8,000 (moving expenses). The inheritance and life insurance proceeds are exclusions from gross income. The payment by Karen of her church pledge is a deduction *from* AGI. Thus, it does not enter into the determination of AGI.

102. Gene is single and for 2010 has AGI of $40,000. He is age 65 and has no dependents. For 2010, he has itemized deductions *from* AGI of $7,000. Determine Gene's taxable income for 2010.

$29,250. Gene's standard deductions are $5,700 (basic) + $1,400 (additional) for a total of $7,100. Consequently, he should select the standard deduction option since it exceeds his itemized deductions of $7,000. Thus, his taxable income is determined as follows: $40,000 (AGI) – $7,100 (standard deductions) – $3,650 (personal exemption) = $29,250.

103. Warren, age 17, is claimed as a dependent by his father. In 2010, Warren has dividend income of $1,500 and earns $400 from a part-time job.

a. What is Warren's taxable income for 2010?
b. Suppose Warren earned $1,200 (not $400) from the part-time job. What is Warren's taxable income for 2010?

a. $950. Warren's standard deduction is the greater of $400 (earned income) + $300 *or* $950. Thus, $1,500 + $400 – $950 = $950 taxable income.
b. $1,200. Warren's standard deduction now becomes $1,500 ($1,200 + $300). Thus, $1,500 + $1,200 – $1,500 = $1,200 taxable income.

104. Meg, age 23, is a full-time law student and is claimed by her parents as a dependent. During 2010, she received $1,400 interest income from a bank savings account and $5,600 from a part-time job. What is Meg's taxable income for 2010?

$1,300. Meg's standard deduction is the greater of $5,600 (earned income) + $300 *or* $950. But the $5,900 is limited to $5,700 (the standard deduction allowed a single person). Thus, $1,400 + $5,600 – $5,700 = $1,300 taxable income.

105. Heloise, age 74 and a widow, is claimed as a dependent by her daughter. For 2010, she had income as follows: $2,500 interest on municipal bonds; $3,200 Social Security benefits; $3,000 income from a part-time job; and $2,800 dividends on stock investments. What is Heloise's taxable income for 2010?

$1,100. $3,000 (income from job) + $2,800 (dividends) – $3,300 (basic standard deduction is $3,000 + $300) – $1,400 (additional standard deduction for age) = $1,100. The Social Security benefits of $3,200 and the interest on municipal bonds of $2,500 are not taxable.

106. Pablo is married to Elena, who lives with him. Both are U.S. citizens and residents of Kansas. Pablo furnishes all of the support of his parents, who are citizens of Nicaragua and residents of Mexico. He also furnishes all of the support of Elena's parents, who are citizens and residents of Nicaragua. Elena has no gross income for the year. If Pablo files as a married person filing separately, how many personal and dependency exemptions can he claim on his return?

Four. A personal exemption for Pablo and Elena and dependency exemptions for Pablo's parents. Elena can be claimed because she has no income. Presumably she is not being claimed as a dependent by another. Although Pablo's parents are neither U.S. citizens nor residents, they are residents of Mexico. Elena's parents meet neither the citizenship nor residency tests.

107. Homer (age 68) and his wife Jean (age 70) file a joint return. They furnish all of the support of Luther (Homer's 90-year old father), who lives with them. For 2010, they received $6,000 of interest income on city of Chicago bonds and interest income on corporate bonds of $48,000. Compute Homer and Jean's taxable income for 2010.

$23,450. Their gross income is $48,000 since the $6,000 interest on municipal bonds is an exclusion. They are entitled to a basic standard deduction of $11,400 and additional standard deductions of $1,100 each for being age 65 or older. They can claim a dependency exemption of $3,650 for Luther and two personal exemptions for themselves. Thus, $48,000 – $11,400 – $2,200 (2 ´ $1,100) – $10,950 (3 ´ $3,650) = $23,450.

108. Ellen, age 39 and single, furnishes more than 50% of the support of her parents, who do not live with her. Ellen practices as a self-employed interior decorator and has gross income in 2010 of $120,000. Her deductions are as follows: $30,000 business and $8,100 itemized.

a. What is Ellen's taxable income for 2010?
b. Can Ellen qualify for head of household filing status? Explain.

a. $70,650. $120,000 (gross income) - $30,000 (business deductions *for* AGI) = $90,000 (AGI) – $8,400 (standard deduction) – $3,650 (personal exemption) – $7,300 (dependency exemptions for parents) = $70,650 taxable income. The answer presumes that the parents meet the other dependency exemption tests (e.g., gross income) besides support.

b. Ellen can qualify for head of household filing status if she furnishes more than half of the cost of maintaining her parents' household. Also, at least one of Ellen's parents must qualify as her dependent (see part a. above).

109. Ashley earns a salary of $35,000, has capital gains of $4,000, and interest income of $3,000 in 2010. Her husband died in 2009. Ashley has a dependent son, Tyrone, who is age 8. Her itemized deductions are $9,000.

a. Calculate Ashley's taxable income for 2010.
b. What is her filing status?

a.

Salary	$35,000
Capital gains	4,000
Interest	3,000
AGI	$42,000
Less: Standard deduction	(11,400)
Less: Personal exemption and dependency deduction ($3,650 ´ 2)	(7,300)
Taxable income	$23,300

b. Ashley satisfies the requirements for a surviving spouse.

110. During the year, Marcus had the following transactions:

Long-term loss on the sale of business use equipment	$6,000
Long-term loss on the sale of personal use camper	2,000
Long-term gain on the sale of personal use boat	1,000
Short-term loss on the sale of stock investment	3,000
Long-term loss on the sale of land investment	4,000

How are these transactions handled for income tax purposes?

Ordinary loss of $6,000 on the business equipment. The $2,000 loss on the camper is personal and not deductible. However, the $1,000 gain on the boat is taxable and is applied against the long-term capital loss on the land, reducing it to $3,000. The $3,000 short-term capital loss on the stock offsets ordinary income. The unused remaining $3,000 long-term capital loss from the land sale is carried over to future years.

111. During 2010, Dena has the following gains and losses:

LTCG	$4,000
LTCL	1,000
STCG	500
STCL	3,000

a. How much is Dena's tax liability if she is in the 15% tax bracket?
b. If her tax bracket is 33% (not 15%)?

a. $0. After the initial netting process, there is a LTCG of $3,000, and a STCL of $2,500. The $2,500 of STCL is applied to the LTCG of $3,000. The final result is a net LTCG of $500 taxed at 0% for a tax liability of $0.

b. $75. See part a. for the netting process. Now the $500 is taxed at 15% for a tax liability of $75.

112. During 2010, Marlo had the following capital gains and losses:

Gain from the sale of coin collection (held three years)	$5,000
Gain from the sale of land held as an investment for six years	4,000
Gain from the sale of stock held as an investment (held for 10 months)	1,000

a. How much is Marlo's tax liability if he is in the 15% tax bracket?
b. If his tax bracket is 33% (not 15%)?

a. $900. Gain of $5,000 on the sale of the coin collection is taxed at 15% (lesser of 28% or 15%). The same is true for the short-term gain of $1,000. The gain of $4,000 on the sale of the land is taxed at 0%. Thus, (15% ´ $6,000) + (0% ´ $4,000) = $900.

b. $2,330. (33% ´ $1,000) + (28% ´ $5,000) + (15% ´ $4,000) = $2,330.

113. During 2010, Carmen had salary income of $90,000 and the following capital transactions:

LTCG	$4,000
LTCL	5,000
STCG	4,000
STCL	2,000

How are these transactions handled for income tax purposes?

Combining the long-term transactions yields a net LTCL of $1,000 ($4,000 – $5,000), while the short-term process results in a net STCG of $2,000 ($4,000 – $2,000). A further combination leaves a net STCG of $1,000 ($2,000 – $1,000) which is taxed as ordinary income. Only net LTCG results in preferential tax treatment.

114. Mr. Lee is a citizen and resident of Hong Kong, while Mr. Anderson is a citizen and resident of the U.S. In the taxation of income, Hong Kong uses a territorial approach, while the U.S. follows the global system. In terms of effect, explain what this means to Mr. Lee and Mr. Anderson.

Mr. Lee is taxed only on the income he receives from Hong Kong, while Mr. Anderson is taxed on his global income. Under the U.S. approach, a citizen or resident is taxed on a worldwide basis. Since the U.S. system could lead to the same income being taxed twice, various relief provisions are necessitated (e.g., foreign tax credit).

115. During the current year, Doris received a large gift from her parents and a sizeable inheritance from an uncle. She also paid premiums on an insurance policy on her life. Doris is confused because she cannot find any place on Form 1040 to report these items. Explain.

Gifts and inheritances are exclusions from gross income. Like most exclusions, they are not reported on Form 1040. Premiums on a personal life insurance policy are nondeductible. Nondeductible items, such as these premiums, are not reported on Form 1040

116. Mel is not quite sure whether an expenditure he made is a deduction *for* AGI or a deduction *from* AGI. Since he plans to choose the standard deduction option for the year, does the distinction matter? Explain.

It makes a great deal of difference if the expenditure is a deduction *for* AGI. If it is, Mel will benefit taxwise. It makes no difference, however, if it is a deduction *from*. The standard deduction is in lieu of itemized deductions.

117. In satisfying the support test and the gross income test for claiming a dependency exemption, a scholarship received by the person being claimed is handled the same way for each test. Do you agree or disagree with this statement? Why?

Disagree. For purposes of the support test, all of the scholarship is disregarded. For purposes of the gross income test, only the taxable part is considered (i.e., the nontaxable part is disregarded).

118. In order to claim a dependency exemption for other than a qualifying child, a taxpayer must meet the support test. Generally, this is done by furnishing more than 50% of a dependent's support. What exceptions exist, if any, where the support furnished need not be more than 50%?

One exception involves the multiple support agreement. Here, family members collectively furnish more than 50% of the support, but no one person does so. For those qualified individuals who contribute more than 10%, the group can designate which person may claim the dependency exemption.

The second exception involves the divorced parents of children. The custodial parent is entitled to the dependency exemptions for the children. If this parent agrees not to claim the exemption(s), then the noncustodial parent may do so.

119. In applying the gross income test in the case of dependents that are married, could the application of community property laws have any effect? Explain.

Most often, the application of community property laws will impact on the dependency status of the spouse of a qualifying child. Suppose, for example, Roger maintains a household that includes his 18-year-old daughter, Alice, and her husband, Craig. Assume further that Alice earns $8,000 from a part-time job while Craig has no income. In a common law state, Craig meets the gross income test (i.e., $0) while Alice's gross income, as a qualifying child, is immaterial. In a community property state, however, Craig now violates the gross income test with $4,000 (50% ´ $8,000) of income, while Alice remains immune.

120. In meeting the criteria of a qualifying child for dependency exemption purposes, when if ever, might the child's income become relevant?

The amount of income earned by the qualifying child normally is of no consequence. If, however, such income is used to make the child self-supporting, then he or she can no longer be a qualifying child. Such child also would not be a qualifying relative due to the gross income and support tests.

121. Mickey, age 12, lives in the same household with his mother, grandmother, and uncle.

a. Under the qualifying child rules, which of these family members can claim Mickey as a dependent? Who would prevail?

b. Suppose the mother has no income and does not even file a return.

a. Mickey is a qualifying child as to all parties. Under the tie-breaker rules, the mother (as the only parent involved) would prevail.

b. Whoever has the highest AGI. However, the tie-breaker rules will not apply if the parties choose not to use them.

122. What is a "stealth tax?"

A "stealth tax" is not really a separate tax. Most often, it consists of conditions in the tax law that deny the benefits of a relief provision to persons in higher tax brackets. The stealth tax approach previously took the phaseout form in the case of the deduction for personal and dependency exemptions and the allowance of deductions *from* AGI.

123. Contrast the tax consequences resulting from the following filing status situations:

a. Married filing jointly versus married filing separately.
b. Married filing separately versus single filing separately.
c. Married filing separately versus abandoned spouse status.

a. Married persons filing jointly have a number of tax elections available to them that cannot be chosen if they file separate returns. For example, the credit for child and dependent care expenses and the earned income credit are not available unless married persons file joint returns.
b. Married persons filing separately often will not fare as well as the couple that remains single. For one advantage, each single person has full flexibility in choosing between the standard deduction and itemizing and is not bound by what the companion does. A second advantage is the ability of each to apply a full $3,000 of excess capital losses against ordinary income. For married persons filing separate returns, the ordinary income offset is restricted to $1,500 each.
c. Since abandoned spouse status means that the taxpayer is treated as being single, the same advantages mentioned in part a. above exist when compared to married persons filing separate returns. Even more advantageous is that abandoned spouse status permits the use of head of household filing status. Head of household tax rates are lower than those applicable to single persons (and married persons filing separate returns). Also, the standard deduction amount for head of household filing status is larger than that available to single persons (and married persons filing separate returns).

124. Regarding head of household filing status, comment on the following:

a. A taxpayer qualifies even though he maintains a household which he and the dependent *do not* share.
b. A taxpayer does not qualify even though the person sharing the household *is* a dependent.
c. The usual eventual filing status of a surviving spouse.

a. If the household is that of a dependent parent, it need not be taxpayer's household.
b. If the household does not include a dependent that meets the relationship test, head of household filing status is unavailable. An example would be a taxpayer who maintains a household for a cousin who lives with her. Even if the cousin is a dependent under the member of the household test, taxpayer does not qualify for head of household filing status. A cousin does not satisfy the relationship test.
c. Once the two-year surviving spouse period terminates, the taxpayer usually will qualify for head of household filing status.

125. The major advantage of being classified as an abandoned spouse is that the taxpayer is treated for tax purposes as being single and not married. This means that an abandoned spouse can use the more favorable tax rates available to single persons than those available to married persons filing separately. Comment on the accuracy of this conclusion.

The conclusion is incorrect. The classification of abandoned spouse allows the taxpayer to the use of the rates for head of household filing status which are less progressive than married filing separately.

126. For the past few years, Corey's filing status has been as follows: 2006 (married/joint); 2007 (married/separate); 2008 (surviving spouse); 2009 (surviving spouse); and 2010 (head of household). Explain what probably has happened.

One probable explanation is that Corey's wife died in 2007 and the executor of her estate refused to agree to filing a joint return. As surviving spouse status does not continue beyond two years, Corey is relegated to head of household status in 2010.

127. DeWayne is a U.S. citizen and resident. He spends much of each year in the United Kingdom on business. He is married to Petula, a U.K. citizen and resident of London. DeWayne has heard that it is possible that he can file a joint income tax return for U.S. purposes. If this is so, what are the constraints he should consider in making any such decision?

The election to file a joint return has the effect of treating Petula as a U.S. resident. Unfortunately, this places Petula on the U.S. global approach to taxation. If Petula has considerable income of her own, the election makes this income subject to U.S. taxation which may be disadvantageous.

128. List at least three exceptions to the application of the kiddie tax.

- Unearned income of $1,900 or less.
- Age 19 (or age 24 if a full-time student) or older.
- Both parents deceased.
- Earned income in excess of 50% of support.
- Married and filing a joint return with spouse.

129. The Martins have a teenage son who has become an accomplished bagpiper. With proper promotion and scheduling, the son has good income potential by charging for his services at special events (particularly funerals). However, the Martins are fearful that the income could generate a kiddie tax and cause them the loss of a dependency exemption deduction. Are the Martins' concerns justified? Explain.

The income received by the son would be earned income. Therefore, the kiddie tax is not a problem since it applies only to unearned income. As long as the son is under age 19 (or a full-time student under age 24), he is a dependent as a qualifying child. Under these rules, the amount of the son's income does not matter (unless he becomes self-supporting). If the son is age 19 (or older) and not a student, any dependency exemption must satisfy the qualifying relative rules. Here, not meeting the gross income test would cause the dependency exemption to be lost.

130. In early 2010, Ben sold a yacht, held for 9 months and for pleasure, for a $5,000 gain. Concerned about offsetting the gain before year-end, Ben is considering selling one of the following—each of which would yield a $5,000 loss:

· Houseboat used for recreation.

· Truck used in business.

· Stock investment held for 13 months.

Evaluate each choice.

The sale of the houseboat produces no benefit since losses on personal use property are not deductible. The sale of the truck yields an ordinary loss of $5,000. The ordinary loss result offsets the ordinary income caused by a short-term capital gain. The best choice, however, is the stock investment. A net long-term capital loss can neutralize a net short-term capital gain and prevent ordinary income from materializing. By itself, a net long-term capital loss can only be offset against regular income to the extent of $3,000. Also, it might obviate long-term capital gains which are taxed at preferential tax rates.

131. After paying down the mortgage on their personal residence, the Hills have found that their itemized deductions for each year are always slightly less than the standard deduction option.

a. Explain what has happened.
b. What remedy do you suggest?

a. Paying down the mortgage reduced the interest expense deduction. With less interest expense, the Hills' deductions *from* AGI no longer exceed the standard deduction amount.
b. The Hills should begin concentrating their other itemized deductions (e.g., charitable contributions) by paying for multiple years in the same year. Being on a cash basis, the timing of the deduction is based on the year of payment. In alternate years, moreover, the standard deduction is claimed.

132. Maude's parents live in another state and she cannot claim them as her dependents. If Maude pays their medical expenses, can she derive any tax benefit from doing so? Explain.

If Maude could otherwise claim her parents as dependents except for not satisfying either the gross income or the joint return tests, she can claim any medical expenses paid on their behalf.