

## CHAPTER 2 – SOLUTIONS

### END OF CHAPTER MATERIAL

#### Discussion Questions

1. What is a *for* AGI deduction? Give three examples.

**Learning Objective: 02-01**

**Topic: Form 1040 and 1040A**

**Difficulty: 1 Easy**

**Feedback: A deduction for AGI is a deduction permitted under the IRC that is used to calculate AGI. It can also be thought of as a deduction from gross income to arrive at AGI. Examples include deductions for IRAs, Keoghs, or other self-employed qualified pension plans; student loan interest; moving expenses; one-half the self-employment tax; self-employed health insurance deduction; penalty on early withdrawal of savings; and alimony paid.**

**EA: Yes**

2. What are the five types of filing status?

**Learning Objective: 02-02**

**Topic: Filing Status**

**Difficulty: 1 Easy**

**Feedback: The five types of filing status are:**

**Single**

**Married filing a joint return**

**Married filing separate returns**

**Head of household**

**Qualifying widow(er) with dependent child**

**EA: Yes**

3. What qualifications are necessary to file as head of household?

**Learning Objective: 02-02**

**Topic: Filing Status**

**Difficulty: 1 Easy**

**Feedback: To qualify as head of household, the taxpayer must be unmarried at the end of the tax year, be a U.S. citizen or resident throughout the year, not be a qualifying widow(er), and maintain a household that is the principal place of abode of a *qualifying person* for more than half the year or pay more than half the costs of maintaining a separate household for the taxpayer's mother or father if the mother or father qualifies as a dependent of the taxpayer. Temporary absences, such as attending school do not disqualify the person under this section.**

**EA: Yes**

4. George and Debbie were legally married on December 31, 2015. Can they file their 2015 income tax return using the status of married filing jointly? Why or why not? What other filing status choices do they have, if any?

**Learning Objective: 02-02**

**Topic: Filing Status**

**Difficulty: 1 Easy**

**Feedback: Yes, George and Debbie can file using the filing status of married filing jointly. The requirement for this status is that the couple be legally married on the last day of the tax year. Alternatively, the couple could choose to use the married filing separate status.**

**EA: Yes**

5. What is the amount of the personal and dependency exemptions for 2015?

**Learning Objective: 02-03 and 02-04**

**Topic: Personal and Dependency Exemptions**

**Difficulty: 1 Easy**

**Feedback: The amount is \$4,000 for personal and dependency exemptions.**

**EA: Yes**

6. What are the three general tests that a qualifying person must meet to be a dependent of the taxpayer?

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 1 Easy**

**Feedback: To be a dependent of the taxpayer, a qualifying child and a qualifying relative must meet the three general tests: dependent taxpayer test, joint return test and citizen or resident test.**

**EA: Yes**

7. What are the five specific tests necessary to be a qualifying child of the taxpayer?

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 1 Easy**

**Feedback: A person is a qualifying child if he or she meets all five of the following tests: relationship test, age test, residency test, support test, and special test - for qualifying child of more than one taxpayer.**

**EA: Yes**

8. What age must a child be at the end of the year to meet the age test under the qualifying child rules?

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 1 Easy**

**Feedback: At the end of the year, the child must be: under the age of 19; under the age of 24 and a full-time student; or totally and permanently disabled regardless of age. In addition, after 2008, the child must be younger than the person claiming the dependency.**

**EA: Yes**

9. What are the four specific tests necessary to be a qualifying relative of the taxpayer?

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 1 Easy**

**Feedback: A person qualifies as a qualifying relative if he or she meets all four of the following tests: not a qualifying child test, relationship or member of household test, gross income test, and support test.**

**EA: Yes**

10. What is a multiple support agreement, and what is its purpose?

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 2 Medium**

**Feedback: Normally, in order to claim someone as a dependent a taxpayer must provide more than half the support of the person. At times, an individual may receive support from multiple persons, but no one person has provided more than 50% of the support. In such a case, a multiple support agreement can be signed. If every one of the persons providing support could claim the individual as a dependent (absent the support test) then one person who provided more than 10% of the support can receive the dependency exemption if all persons sign a written multiple support agreement.**

**The purpose of the agreement is so someone can obtain the dependency exemption rather than no one. Further, the agreement provides a mechanism such that all parties can agree on who that person should be.**

**EA: Yes**

11. Mimi is 22 years old and is a full-time student at Ocean County Community College. She lives with her parents, who provide all of her support. During the summer, she put her Web design skills to work and earned \$4,100. Can Mimi's parents claim her as a dependent on their joint tax return? Why or why not? Assume that all five tests under qualifying child are met.

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 2 Medium**

**Feedback:** All of the dependency tests are met by Mimi's parents, so they can claim her as a dependent. The fact that Mimi earned \$4,100 does not matter since Mimi is under age 24 and she is a full-time student at a qualifying educational institution. Thus, the gross income test is not necessary for a qualifying child as long as Mimi does not provide more than half of her own support.

**EA: Yes**

12. What is the standard deduction for each filing status?

**Learning Objective: 02-05**

**Topic: Standard Deduction**

**Difficulty: 1 Easy**

**Feedback:** The standard deduction for each filing status for 2015 is:

Single	\$ 6,300
Married filing jointly	12,600
Married filing separately	6,300
Head of household	9,250
Qualifying widow(er)	12,600

**EA: Yes**

13. Under what circumstances must a taxpayer use a tax rate schedule rather than using a tax table?

**Learning Objective: 02-06**

**Topic: Tax Computation**

**Difficulty: 1 Easy**

**Feedback:** If the taxable income of a taxpayer is \$100,000 or more, a tax rate schedule must be used. Taxable income of less than \$100,000 requires the use of a tax table.

**EA: Yes**

14. When and at what rate is interest calculated on amounts owed to the IRS?

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 2 Medium**

**Feedback:** If the taxpayer still owes tax after April 15<sup>th</sup>. The rate charged is the federal short-term rate plus 3 percentage points.

**EA: Yes**

15. Prepare a table of the possible IRS penalties listed in the text and give a brief summary of the purpose of each penalty.

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 2 Medium**

**Feedback:**

<b>Penalty</b>	<b>Reason for Penalty</b>
<b>Interest charged on assessments</b>	<b>To encourage taxpayers to pay assessments in a timely manner and to compensate the government for the time-value of late payments</b>
<b>Failure to file a tax return</b>	<b>To reprimand taxpayers for failing to file a tax return</b>
<b>Failure to pay tax</b>	<b>To seek retribution from taxpayers who fail to pay tax</b>
<b>Failure to pay estimated taxes</b>	<b>To penalize taxpayers for failing to pay estimated taxes throughout the year</b>
<b>Accuracy-related penalties</b>	<b>To seek retribution from taxpayers for underpayments or submitting tax returns with errors</b>
<b>Fraud penalties</b>	<b>To penalize taxpayers for providing fraudulent information</b>
<b>Erroneous claim for refund or credit penalty</b>	<b>To penalize taxpayers for filing an excessive claim for refund or credit of income tax</b>

**EA: Yes**

### **Multiple Choice**

16. A single taxpayer is 27 years old and has wages of \$17,000 and interest income of \$450. Which is the simplest tax form this person can file?

- 1040.
- 1040EZ.
- 1040A.
- 1040Z.

**Answer: b.**

**Learning Objective: 02-01**

**Topic: Form 1040 and 1040A**

**Difficulty: 1 Easy**

**Feedback: The simplest form to file is the 1040EZ. The taxpayer, who is under age 65 and not blind, is single with no dependent, and his income of wages and interest income of only \$450 is less than \$100,000.**

**EA: Yes**

17. Payment of alimony by the taxpayer is a *for AGI* deduction. Which form can the taxpayer use to claim this benefit?

- Either 1040 or 1040A.
- 1040A.

- c. 1040.
- d. None of the above.

**Answer: c.**

**Learning Objective: 02-01**

**Topic: Form 1040 and 1040A**

**Difficulty: 1 Easy**

**Feedback: Alimony deductions can only be claimed on Form 1040.**

**EA: Yes**

18. A taxpayer is married with a qualifying child (dependent), but she has been living separately from her spouse for the last eight months of the year. However, she paid for more than half of the cost of keeping up the household. Her spouse does not want to file jointly. What filing status must she use when filing her tax return? She wants to obtain the maximum legal benefit.

- a. Married filing separately.
- b. Single.
- c. Qualifying widow(er).
- d. Head of household.

**Answer: d.**

**Learning Objective: 02-02**

**Topic: Filing Status**

**Difficulty: 1 Easy**

**Feedback: A taxpayer is considered unmarried for purposes of this section if the spouse was living apart during the last six months of the tax year.**

**EA: Yes**

19. A taxpayer's spouse died on December 31, 2014. He has no qualifying child. Which status should the taxpayer select when filing his 2015 tax return?

- a. Qualifying widow(er).
- b. Married filing jointly.
- c. Single.
- d. Married filing separately.

**Answer: c.**

**Learning Objective: 02-02**

**Topic: Filing Status**

**Difficulty: 1 Easy**

**Feedback: The surviving spouse may be eligible to file as a qualifying widow(er) only if certain conditions are met, which include keeping a household as the principal place of abode for the entire year of both the surviving spouse and a child, stepchild, or adopted child who can be claimed as a dependent by the surviving spouse.**

**EA: Yes**

20. Esmeralda is 20 years of age and a full-time student living with her parents. She had wages of \$500 (\$50 of income tax withholding) for 2015. Can Esmeralda claim her own exemption on her return even though her parents will claim her as a dependent?
- Yes, Esmeralda can claim the exemption.
  - No, Esmeralda cannot claim the exemption.
  - Esmeralda and her parents can both claim the exemption.
  - No one can claim the exemption for Esmeralda.

**Answer: b.**

**Learning Objective: 02-03**

**Topic: Personal Exemption**

**Difficulty: 1 Easy**

**Feedback: Esmeralda qualifies as a dependent of her parents; therefore, no personal exemption is allowed on her return.**

**EA: Yes**

21. What is the amount of the personal and dependency exemptions for 2015?
- \$3,950.
  - \$3,800.
  - \$3,900.
  - \$4,000.

**Answer: d.**

**Learning Objective: 02-03 and 02-04**

**Topic: Personal and Dependency Exemptions**

**Difficulty: 1 Easy**

**Feedback: The amount of the personal and/or dependency exemption for 2015 is \$4,000.**

**EA: Yes**

22. To be a qualifying child, the taxpayer must meet three general tests and five specific tests. Which of the following is *not* part of the five specific tests?
- Support test.
  - Age test.
  - Gross income test.
  - Relationship test.

**Answer: c.**

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 1 Easy**

**Feedback: The gross income test does not apply to a qualifying child; only to a qualifying relative.**

**EA: Yes**

23. To be a qualifying relative, who has to live in the home of the taxpayer for the entire year?
- a. Cousin.
  - b. Child.
  - c. Stepchild.
  - d. Father.

**Answer: a.**

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 2 Medium**

**Feedback: A cousin does not meet the relationship test under this area. He/she must live in the taxpayer's household for the entire year.**

**EA: Yes**

24. Which amount represents the standard deduction for a taxpayer who is 43 years old and claiming head of household status?
- a. \$9,100.
  - b. \$9,250.
  - c. \$8,950.
  - d. \$6,300.

**Answer: b.**

**Learning Objective: 02-05**

**Topic: Standard Deduction**

**Difficulty: 1 Easy**

**Feedback: The standard deduction for a taxpayer under age 65 and claiming head of household status is \$9,250.**

**EA: Yes**

25. A married couple, both of whom are under 65 years old, decided to file as married filing separately. One of the spouses is going to itemize deductions instead of taking the standard deduction. What is the standard deduction permitted to the other spouse when she files her tax return?
- a. \$12,600.
  - b. \$9,250.
  - c. \$6,300.
  - d. \$0.

**Answer: d**

**Learning Objective: 02-05**

**Topic: Standard Deduction**

**Difficulty: 1 Easy**

**Feedback: When filing as married filing separately, if one of the spouses itemizes, then the other spouse must itemize or receive a standard deduction of zero.**

**EA: Yes**



26. Employers are required to withhold social security taxes from wages paid to employees. What is the amount of the social security wage limitation for 2015?
- a. \$118,500.
  - b. \$117,000.
  - c. \$113,700.
  - d. \$106,800.

**Answer: a**

**Learning Objective: 02-06**

**Topic: Tax Computation**

**Difficulty: 1 Easy**

**Feedback: The new amount of the social security wage limitation for 2015 is \$118,500.**

**EA: Yes**

27. What is the amount of the tax liability for a married couple filing jointly with taxable income of \$135,500?
- a. \$37,940.
  - b. \$25,463.
  - c. \$20,325.
  - d. \$25,588.

**Answer: b**

**Learning Objective: 02-06**

**Topic: Tax Computation**

**Difficulty: 2 Hard**

**Feedback: The amount is \$25,463 computed as follows:  
(\$135,500-\$74,900).25 plus \$10,312.50.**

**EA: Yes**

28. What is the percentage of interest the IRS was charging on assessment (amount of unpaid tax liability) during March 2015? You might want to do this research by going to the IRS Web site ([www.irs.gov](http://www.irs.gov)).
- a. 6%.
  - b. 5%.
  - c. 3%.
  - d. 4%.

**Answer: c**

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 1 Easy**

**Feedback: The interest rate is 3% for underpayments occurring during March of 2015.**

**EA: Yes**

29. When there is negligence on a return, the IRS charges a penalty of \_\_\_\_\_ of the tax due.
- 25%.
  - 20%.
  - 18%.
  - 10%.

**Answer: b**

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 1 Easy**

**Feedback: The IRS can assess a penalty equal to 20% of the tax due when negligence has occurred.**

**EA: Yes**

30. When there is fraud on a return, the IRS charges a penalty of \_\_\_\_\_ on any portion of understatement of tax that is attributable to the fraud.
- 20%.
  - 25%.
  - 75%.
  - 100%.

**Answer: c**

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 1 Easy**

**Feedback: The IRS can impose a penalty of 75% on any portion of understatement of tax that is attributable to fraud.**

**EA: Yes**

## **Problems**

31. The benefits of many deductions, credits, or other benefits are limited to taxpayers with Adjusted Gross Income below certain limits.
- Explain how the limitation (phaseout) process works.
  - Give two examples of deductions, credits, or other benefits that are limited.
  - Why would Congress wish to limit the benefits of these items?

**Learning Objective: 02-01**

**Topic: Form 1040 and 1040A**

**Difficulty: 2 Medium**

**Feedback:**

- Taxpayers with AGI in excess of certain specified amounts are prohibited from utilizing the full amount of many deductions, credits, or other tax benefits. Many tax benefits are structured such that taxpayers with low AGI are not limited, taxpayers with high AGI receive no benefit, and taxpayers in**

- the middle receive a reduced benefit as AGI increases. Sometimes a specified AGI amount represents the dividing line between receiving the full amount of a benefit or not receiving any benefit.
- b. Examples of benefits which are subject to limitation include: earned income tax credit, child care credit, child tax credit, and deductibility of IRA contributions.
  - c. There may be a number of reasons why Congress might restrict benefits. First, reducing benefits results in higher taxable income and tax liability, thus increasing tax revenues. Second, taxpayers with higher AGI are often deemed to be able to financially afford fewer benefits and higher taxes since they have more money to start with. Third, and somewhat ironically, there are fewer high income voters compared to low and moderate income voters.

EA: Yes

32. List the five types of filing status and briefly explain the requirements for the use of each one.

**Learning Objective: 02-02**

**Topic: Filing Status**

**Difficulty: 1 Easy**

**Feedback: The five types of filing status and requirements are:**

*Single.* Taxpayer must be unmarried on the last day of the tax year and must not qualify as either head of household or qualifying widow(er).

*Married filing a joint return.* Taxpayers must be legally married on the last day of the tax year. Taxpayers in the process of getting a divorce can file with this classification as long as the divorce is not final. Generally, neither taxpayer can be a nonresident alien at any time during the tax year.

*Married filing separate returns.* Taxpayers must meet the requirements for married filing jointly and can then choose to file married filing separately.

*Head of household.* In order to qualify as head of household, the taxpayer must be unmarried at the end of the tax year, be a U.S. citizen or resident throughout the year, not be a qualifying widow(er), and maintain a household that is the principal place of abode of a *qualifying person* for more than half the year. If the mother or father of the taxpayer qualifies as a dependent of the taxpayer, the taxpayer can be eligible for head of household status by paying more than half the costs of maintaining a separate household that is the principal place of abode for the mother or father.

*Qualifying widow(er) with dependent child.* During the two years following the year of death of a spouse, a taxpayer can file as a qualifying widow(er) if the taxpayer did not remarry and if the taxpayer maintained a household which was the principal place of abode for the entire year of the taxpayer

**and a dependent child, stepchild, or adopted child. In addition, the taxpayer must have been eligible to file a joint return in the year the spouse died.**

**EA: Yes**

33. In which of the following cases may the taxpayer claim head of household filing status?

- a. The taxpayer is single and maintains a household that is the principal place of abode of her infant son.
- b. The taxpayer is single, maintains a household for herself, and maintains a separate household that is the principal place of abode of her dependent widowed mother.
- c. The taxpayer was married from January to October and lived with his spouse from January to May. From June 1 to December 31, the taxpayer maintained a household that was the principal place of abode of his married son and daughter-in-law, whom the taxpayer can claim as dependents.
- d. Same as (c) except the taxpayer lived with his ex-spouse until August and maintained the household from September 1 to the end of the year.

**Learning Objective: 02-02**

**Topic: Filing Status**

**Difficulty: 2 Medium**

**Feedback:**

- a. **The taxpayer can claim head of household status.**
- b. **The taxpayer can claim head of household status. It is not necessary that her mother live in the same household as the taxpayer.**
- c. **The taxpayer can claim head of household status.**
- d. **The taxpayer cannot claim head of household status. The son and daughter-in-law must live with the taxpayer for more than half the tax year. And the taxpayer cannot live with his or her spouse during the last 6 months of the year.**

**EA: Yes**

34. How many personal exemptions can a taxpayer claim on his or her tax return? Explain your answer.

**Learning Objective: 02-03**

**Topic: Personal Exemption**

**Difficulty: 1 Easy**

**Feedback: The taxpayer is only entitled to one personal exemption (\$4,000 for 2015) for himself or herself. However, if he or she is married, then another personal exemption can be claimed for the spouse.**

**EA: Yes**

35. Roberta is widowed and lives in an apartment complex. She receives \$8,000 of social security income that she uses to pay for rent and other household expenses. The remainder of her living expenses is paid by relatives and neighbors. The total amount of

support paid by Roberta and the others totals \$22,000. Amounts paid for support during the year are as follows:

Roberta	\$8,000
Ed (neighbor)	4,000
Bill (son)	5,000
Jose (neighbor)	2,000
Alicia (niece)	3,000

- Which of these persons is entitled to claim Roberta as a dependent absent a multiple support agreement?
- Under a multiple support agreement, which of these persons is entitled to claim Roberta as a dependent? Explain your answer.
- If Roberta saved all of her social security income and the other persons paid for the shortfall in the same proportions as shown, which of these persons would be entitled to claim Roberta as a dependent under a multiple support agreement? Explain your answer.

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 3 Hard**

**Feedback:**

- Absent a multiple support agreement, no one is allowed to claim Roberta as a dependent.**
- If a multiple support agreement were executed, no one would be able to claim Roberta as a dependent. A person is entitled to claim a dependent under a multiple support agreement if (1) over half the dependent's support was received from a group of people who would each have been entitled to claim the person as a dependent absent the support test, (2) no one person in the group provided over half the support, and (3) the person claiming the exemption paid over 10% of the support. In this instance, the only persons entitled to claim Roberta as a dependent absent the support test are Bill and Alicia since neither Ed and Jose meet the relationship test (this assumes that Roberta is Alicia's aunt by blood and not by marriage). Bill and Alicia contributed only 36% of Roberta's support ( $[\$5,000 + \$3,000] / \$22,000$ ). Thus, criterion #1 above is not met and no one is entitled to the dependency exemption for Roberta.**
- Here, the amount paid in support of Roberta is recalculated as follows (percentages are rounded to the nearest full percent):**

	<b>Original Amount Paid</b>	<b>Percentage of Original Total</b>	<b>Revised Amount Paid</b>
<b>Ed (neighbor)</b>	<b>\$4,000</b>	<b>29%</b>	<b>\$ 6,380</b>
<b>Bill (son)</b>	<b>5,000</b>	<b>36%</b>	<b>7,920</b>
<b>Jose (neighbor)</b>	<b>2,000</b>	<b>14%</b>	<b>3,080</b>

Alicia (niece)	3,000	21%	4,620
	-----		-----
	\$14,000		\$22,000

As in case (b), either Bill or Alicia is entitled to the dependency exemption absent the support test. Between them, they provided over 50% of the support of Roberta and each one of them provided over 10% of her support. Thus, either Bill or Alicia would be entitled to the dependency exemption if a multiple support agreement were executed.

**EA: Yes**

36. Shandra is a U.S. citizen and is the 67-year-old widowed mother of Janet. After retirement, Shandra decided to fulfill a lifelong dream and move to Paris. Shandra receives \$1,000 of interest income, but all of her other living expenses (including rent on her Paris apartment with spectacular views of the Eiffel Tower) are paid by Janet. Janet resides in Chicago. Is Janet entitled to a dependency exemption for Shandra? Explain your answer.

**Learning Objective: 02-04**

**Topic: Dependency Exemptions**

**Difficulty: 2 Medium**

**Feedback: Yes, Janet is entitled to dependency exemption for Shandra.**

The four specific criteria to be able to claim a qualifying relative as a dependent are:

*Not a qualifying child test.* Shandra is not the qualifying child of another taxpayer.

*Relationship test.* Shandra meets the relationship test since she is the mother of Janet.

*Gross income test.* Shandra does not earn equal to or more than the personal exemption amount.

*Support test.* Janet provides over 50% of Shandra's support.

In addition, the general tests are also met:

*Joint return.* Shandra is widowed and will not file a joint return.

*Citizenship test.* Shandra is a U.S. citizen.

*Dependent taxpayer test.* Janet cannot be claimed as a dependent by another person.

The fact that Shandra lives in Paris does not matter. It is not important that a dependent live in the U.S., only that he or she is a citizen of the U.S. (or be a certain resident or national).

**EA: Yes**

37. Donald is a 21-year-old full-time college student. During 2015, he earned \$2,400 from a part-time job and \$1,150 in interest income. If Donald is a dependent of his parents, what is his standard deduction amount? If Donald supports himself and is not a dependent of someone else, what is his standard deduction amount?

**Learning Objective: 02-05**  
**Topic: Standard Deduction**  
**Difficulty: 2 Medium**

**Feedback: Donald’s standard deduction amount if he is a dependent of his parents is the greater of \$1,050 or his earned income plus \$350. Donald’s earned income is \$2,400 so his standard deduction will be \$2,750. If Donald is self-supporting, his standard deduction amount will be \$6,300. EA: Yes**

38. Julio and Martina are engaged and are planning to travel to Las Vegas during the 2015 Christmas season and get married around the end of the year. In 2015, Julio expects to earn \$45,000 and Martina expects to earn \$15,000. Their employers have deducted the appropriate amount of withholding from their paychecks throughout the year. Neither Julio nor Martina has any itemized deductions. They are trying to decide whether they should get married on December 31, 2015, or on January 1, 2016. What do you recommend? Explain your answer.

**Learning Objective: 02-05**  
**Topic: Standard Deduction**  
**Difficulty: 3 Hard**

**Feedback: From a tax perspective, it would be more advantageous for Julio and Martina to marry in 2015.**

**The tax liability of Julio and Martina under each scenario would approximate the following:**

	---- Single Returns ----		
	Martina	Julio	Joint Return
Adjusted Gross Income.....	\$ 15,000	\$ 45,000	\$ 60,000
Standard deduction .....	(6,300)	(6,300)	(12,600)
Personal exemptions.....	(4,000)	(4,000)	(8,000)
	-----	-----	-----
Taxable Income.....	\$ <u>4,700</u>	\$ <u>34,700</u>	\$ <u>39,400</u>
Tax liability .....	\$ 473	\$ 4,748	\$ 4,991

**If Julio and Martina get married in 2015 and file a joint return, they will pay \$4,991 in federal income tax. If they wait until January 1, 2016, their collective tax liability in 2015 would be \$5,221. Thus, for tax purposes, it makes more sense for Julio and Martina to get married in 2015.**

**EA: Yes**

39. Determine the amount of the standard deduction for each of the following taxpayers for tax year 2015:
- a. Ann, who is single.
  - b. Adrian and Caroline, who are filing a joint return. Their son is blind.
  - c. Peter and Elizabeth, who are married and file separate tax returns. Elizabeth will itemize her deductions.

- d. Patricia, who earned \$1,100 working a part-time job. She can be claimed as a dependent by her parents.
- e. Rodolfo, who is over 65 and is single.
- f. Bernard, who is a nonresident alien with U.S. income.
- g. Manuel, who is 70, and Esther, who is 62 and blind, will file a joint return.
- h. Herman, who is 76 and a qualifying widower with a dependent child.

**Learning Objective: 02-05**

**Topic: Standard Deduction**

**Difficulty: 2 Medium**

**Feedback:**

- a. **Ann, \$6,300.**
- b. **Adrian and Caroline, \$12,600. They do not get an additional amount for their son.**
- c. **Peter and Elizabeth, \$0. Since Elizabeth itemizes, Peter must also itemize so both are entitled to no standard deduction, only an itemized deduction.**
- d. **Patricia, \$1,450 (her earned income plus \$350).**
- e. **Rodolfo, \$7,850 (\$6,300 + \$1,550).**
- f. **Bernard, \$0, since he is a nonresident alien.**
- g. **Manuel and Esther, \$15,100 (\$12,600 + \$1,250 + \$1,250). Each is entitled to an additional standard deduction; Manuel because he is over 65 and Esther because she is blind.**
- h. **Herman, \$13,850 (\$12,600 + \$1,250).**

**EA: Yes**

40. Using the appropriate tax tables or tax rate schedules, determine the amount of tax liability in each of the following instances.
- a. A married couple filing jointly with taxable income of \$32,991.
  - b. A married couple filing jointly with taxable income of \$192,257.
  - c. A married couple filing separately, one spouse with taxable income of \$43,885 and the other with \$56,218.
  - d. A single person with taxable income of \$79,436.
  - e. A single person with taxable income of \$297,784.
  - f. A head of household with taxable income of \$96,592.
  - g. A qualifying widow with taxable income of \$14,019.
  - h. A married couple filing jointly with taxable income of \$11,216.

**Learning Objective: 02-06**

**Topic: Tax Computation**

**Difficulty: 3 Hard**

**Feedback: All answers rounded to the nearest dollar.**

- a. **\$4,024 from the tax table.**
- b. **\$40,883 from the tax rate schedule.**
- c. **\$6,763 and \$9,850 from the tax table.**
- d. **\$15,650 from the tax table.**
- e. **\$81,875 from the tax rate schedule.**



- f. \$18,466 from the tax table.
- g. \$1,403 from the tax table.
- h. \$1,123 from the tax table.

EA: Yes

41. Determine the average tax rate and the marginal tax rate for each instance in question 40.

**Learning Objective: 02-06**

**Topic: Tax Computation**

**Difficulty: 3 Hard**

**Feedback: Answers are rounded to the nearest tenth of a percent. Average rates are determined by dividing the tax liability by the taxable income. Marginal rates are determined by reference to the appropriate tax rate schedule.**

- a. Average = 12.2% Marginal = 15%
- b. Average = 21.3% Marginal = 28%
- c. Average = 15.4% and 17.5% Marginal = 25% and 25%
- d. Average = 19.7% Marginal = 25%
- e. Average = 27.5% Marginal = 33%
- f. Average = 19.1% Marginal = 25%
- g. Average = 10% Marginal = 10%
- h. Average = 10% Marginal = 10%

EA: Yes

42. Using the appropriate tax tables or tax rate schedules, determine the tax liability for tax year 2015 in each of the following instances. In each case, assume the taxpayer can take only the standard deduction.

- a. A single taxpayer with AGI of \$23,493 and one dependent.
- b. A single taxpayer with AGI of \$169,783 and no dependents.
- c. A married couple filing jointly with AGI of \$39,945 and two dependents.
- d. A married couple filing jointly with AGI of \$162,288 and three dependents.
- e. A married couple filing jointly with AGI of \$301,947 and one dependent.
- f. A taxpayer filing married filing separately with AGI of \$68,996 and one dependent.
- g. A qualifying widow, age 66, with AGI of \$49,240 and one dependent.
- h. A head of household with AGI of \$14,392 and two dependents.
- i. A head of household with AGI of \$59,226 and one dependent.

**Learning Objective: 02-06**

**Topic: Tax Computation**

**Difficulty: 3 Hard**

**Feedback:**

- a. Taxpayer is entitled to a standard deduction of \$6,300 and two exemptions of \$4,000 each. Taxable income is \$9,193 and tax liability is \$918 according to the tax tables.

- b. Taxpayer is entitled to a standard deduction of \$6,300 and a personal exemption of \$4,000. Taxable income is \$159,483 and tax liability is \$37,726 according to the tax rate schedules.
- c. Taxpayer is entitled to a standard deduction of \$12,600 and four exemptions of \$4,000 each. Taxable income is \$11,345 and tax is \$1,133 according to the tax tables.
- d. Taxpayer is entitled to a standard deduction of \$12,600 and five exemptions of \$4,000 each. Taxable income is \$129,688 and tax is \$24,010 according to the tax rate schedules.
- e. Taxpayer is entitled to a standard deduction of \$12,600 and three exemptions of \$4,000 each. Taxable income is \$277,347 and tax is \$67,054 according to the tax rate schedules.
- f. Taxpayer is entitled to a standard deduction of \$6,300 and two exemptions of \$4,000 each. Taxable income is \$54,696 and tax is \$9,463 according to the tax tables.
- g. Taxpayer is entitled to a standard deduction of \$13,850 (\$12,600 + \$1,250) and two exemptions of \$4,000 each. Taxable income is \$27,390 and tax is \$3,184 according to the tax tables.
- h. Taxpayer is entitled to a standard deduction of \$9,250 and three exemptions of \$4,000 each. Taxable income is zero and tax is zero.
- i. Taxpayer is entitled to a standard deduction of \$9,250 and two exemptions of \$4,000 each. Taxable income is \$41,976 and tax is \$5,639 according to the tax tables.

**EA: Yes**

43. Victoria's 2015 tax return was due on April 15, 2016, but she did not file it until June 12, 2016. Victoria did not file an extension. The tax due on the tax return when filed was \$8,500. In 2015, Victoria paid in \$12,000 through withholding. Her 2014 tax liability was \$11,500. Victoria's AGI for 2015 is less than \$150,000. How much penalty will Victoria have to pay (disregard interest)?

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 3 Hard**

**Feedback: Victoria must pay a failure to file penalty and failure to pay penalty calculated as follows:**

	<b>\$12,000</b>	withholding paid
+	<b><u>\$ 8,500</u></b>	tax due
	<b>\$20,500</b>	total tax for 2015
	<b>\$ 8,500</b>	underpayment
	<b><u>x10%</u></b>	2 months late × 5% penalty per month (both penalties are combined)
	<b>\$ 850</b>	Failure to file and pay penalties

**In order to avoid the underpayment penalty, Victoria must have paid the lesser of 90% of the current year's tax (\$18,450) or 100% of the prior year's tax (\$11,500). Since she paid \$12,000 in withholding, she does not have to pay the underpayment penalty.**

**EA: Yes**

44. Paul has the following information:

AGI for 2015 = \$155,000  
 Withholding for 2015 = \$ 20,000  
 Total tax for 2014= \$ 29,000  
 Total tax for 2015= \$ 31,250

- a. How much must Paul pay in estimated taxes to avoid a penalty?
- b. If Paul paid \$1,000 per quarter, would he have avoided the estimated tax penalty?

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 3 Hard**

**Feedback:**

- a. **In order to avoid the underpayment penalty, Paul must pay the lesser of 90% of the current year tax (\$28,125) or 100% of the prior year's tax (\$29,000). His withholding for 2015 will be \$20,000. Thus, Paul must pay at least \$8,125 in estimated payments in 2015.**
- b. **No. Assuming Paul's income was earned evenly throughout the year, he would need to pay at least \$2,031 ( $8,125 / 4$ ) per quarter in estimated payments to avoid the estimated income tax penalty.**

**EA: Yes**

45. Charles and Joan Thompson file a joint return. In 2014, they had taxable income of \$92,370 and paid tax of \$14,806. Charles is an advertising executive and Joan is a college professor. During the fall 2015 semester, Joan is planning to take a leave of absence without pay. The Thompsons expect their taxable income to drop to \$70,000 in 2015. They expect their 2015 tax liability will be \$9,581, which will be the approximate amount of their withholding. Joan anticipates that she will work on academic research during the fall semester.

During September, Joan decides to perform consulting services for some local businesses. Charles and Joan had not anticipated this development. Joan is paid a total of \$35,000 during October, November, and December for her work.

What estimated tax payments are Charles and Joan required to make, if any, for tax year 2015? Do you anticipate that the Thompsons will be required to pay an underpayment penalty when they file their 2015 tax return? Explain your answer.

**Learning Objective: 02-07**

**Topic: Interest and Penalties**

**Difficulty: 3 Hard**

**Feedback: Charles and Joan will be required to make estimated payments for tax year 2015. Estimated payments are required equal to the lesser of 90% of the tax shown on the current year return (which we will calculate below) or 100% of the prior year tax (which was \$14,806).**

The amount of estimated payments required for tax year 2015 (using the tax rate schedules) is:

Estimated year 2015 taxable income is \$105,000 (\$70,000 + \$35,000)

Tax on \$74,900.....	\$10,312.50
Tax on \$30,100 (\$105,000 – \$74,900) x 25%.....	7,525.00
	-----
Estimated 2015 tax liability.....	\$17,837.50
	x 90%
	-----
90% of estimated year 2015 tax liability...	\$16,053.75
	=====

Thus, Charles and Joan will need to pay estimated taxes based on \$14,806 (which is the lesser of \$14,806 or \$16,054). Since they will have paid \$9,581 in withholding payments, they will have to pay the difference of \$5,225 in estimated payments. Because the tax liability shortfall was a result of income earned in the final quarter of the tax year, the estimated payment can be made in one payment on or before January 15, 2016.

If Charles and Joan make the estimated payment determined above, it is unlikely they will have an underpayment penalty on their year 2015 tax return.

EA: Yes

**Tax Return Problems**

**Tax Return Problem #1**

The solutions to the chapter tax return problems can be found on the online learning center: [www.mhhe.com/cruz2016](http://www.mhhe.com/cruz2016)

**Tax Return Problem #2**

The solutions to the chapter tax return problems can be found on the online learning center: [www.mhhe.com/cruz2016](http://www.mhhe.com/cruz2016)

**Tax Return Problem #3**

The solutions to the chapter tax return problems can be found on the online learning center: [www.mhhe.com/cruz2016](http://www.mhhe.com/cruz2016)