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## Solutions to Chapter 1 Problem Assignments

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### Check Your Understanding

- [LO 1.1] *What is a tax?*  
**Solution:** A tax is a required payment to a governmental unit to support its operations that is not related to the value of goods or services the person or business receives. A fine is levied as a result of an unlawful act.
- [LO 1.1] *Constitutional Authority*  
**Solution:** The federal income tax system as we know it today did not begin until 1913 when the 16th Amendment to the U.S. Constitution was ratified. The 16th Amendment gave Congress the power to lay and collect taxes “on income, from whatever source derived,” without the previous requirement that all direct taxes be imposed based on population.
- [LO 1.1] *Current Tax Code*  
**Solution:** The Tax Reform Act of 1986 was so extensive, the Code was renamed the *Internal Revenue Code of 1986*. Any current changes to the tax laws are now amendments to the *Internal Revenue Code of 1986*.
- [LO 1.1] *Tax Expenditures*  
**Solution:** Tax expenditures can take the form of special exclusions, deductions, credits or preferential rates for specific activities. These tax expenditures result in a reduction in the revenue that would be collected under a more comprehensive income tax.
- [LO 1.1] *SALT*  
**Solution:** The practice of state and local taxation is commonly referred to as a SALT practice.
- [LO 1.1] *Nexus*  
**Solution:** Nexus is the necessary type and degree of connection between a business and the state in which it is located for the state to impose a tax on its sales or activities
- [LO 1.1] *State Income Tax*  
**Solution:** Without physical presence within Arizona, the state cannot assess state income tax on Suntan Corporation’s sales made to persons or businesses located within Arizona.
- [LO 1.1] *Franchise Tax*  
**Solution:** A franchise tax is an excise tax based on the right to do business or own property in a state. It is usually determined based on corporate income, however, so would, in effect, simply be another name for an income tax.
- [LO 1.1] *State Income Allocation*  
**Solution:** The three-factor allocation formula uses a percentage of corporate sales, payroll costs, and tangible property allocated to the state.
- [LO 1.1] *Employment Taxes*

## 2 Solutions Manual for Taxation for Decision Makers

**Solution:** An employee pays the Social Security and Medicare (FICA) tax; the employer also pays an equivalent Social Security and Medicare (FICA) tax, but the employer also may have to pay an unemployment tax.

### 11. [LO 1.1] *Wealth Taxes*

**Solution:** The most common wealth tax is the real property tax based on the fair market value of property owned by an individual or a business.

### 12. [LO 1.1] *Intangible Tax*

**Solution:** The intangible tax is levied on intangible property such as receivables, stocks, bonds, and other forms of investment instruments owned by businesses and individuals.

### 13. [LO 1.1] *Estate and Gift Tax*

**Solution:** Property that is given away during a lifetime that exceeds an annual allowance per donee is subject to a gift tax; however, the lifetime exemption prevents most gifts from being subject to this tax. Once, however, taxable gifts exceed the lifetime exemption, gifts are subject to the gift tax. When the person passes away, the remaining property owned at death (not previously given away) is now subject to the estate tax. Any gift tax exemption not used previously by the decedent is then available as an exemption from the estate tax. Thus, a decedent's estate escapes taxation unless his or her total lifetime taxable gifts plus taxable transfers at death exceed the lifetime exemption.

### 14. [LO 1.1] *Consumption vs Income Tax*

**Solution:** A consumption tax is levied on purchases of goods or services that are going to be used or consumed. The most common consumption tax is the sales tax, but the value-added tax is another form used in many countries outside the United States. The income tax is based on the value of money or goods that are received, whether it is spent or saved. An income tax will tax money that is going to be saved rather than spent while the consumption tax only taxes money that is spent. The consumption tax is thought to encourage savings.

### 15. [LO 1.1] *Wealth Taxes*

**Solution:** A wealth tax is based on the value of wealth that a person has at a particular point in time. The real or personal property taxes are wealth taxes. The wealth transfer tax is based on the value of money or property that is passed on to another person. The estate, gift, and inheritance taxes are wealth transfer taxes.

### 16. [LO 1.1] *Use Taxes*

**Solution:** A use tax is a companion tax to a sales tax that is imposed on property to be used in one state but which was purchased in another state to which no sales tax was paid on the purchase.

### 17. [LO 1.2] *Income Taxes*

**Solution:** Two single persons with taxable income of \$300,000 each will pay the same total

tax as a married couple with taxable income of \$600,000. Above \$600,000 the married couple's rate increases to 37% but each of the single persons does not reach that rate until taxable income is over \$500,000.

18. [LO 1.2] *Types of Taxes*

**Solution:** The individual income tax system in the United States is a progressive system; that is, as income increases, the tax rate increases and the person pays a greater percentage of income as a tax. A single individual who has \$9,000 of taxable income will pay \$900 in taxes (10%). A single individual who makes \$18,000 will pay \$1,969.50 ( $\$952.50 + .15 (\$18,000 - \$9,525)$ ).  $\$1,969.50 / \$18,000 = 10.94\%$ . A regressive tax system imposes a lower tax rate as income increases; that is, a person pays a decreasing percentage of their income in taxes as income increases. The Social Security portion of the FICA tax is a regressive tax; as the taxpayer's income on which the tax is based exceeds a maximum, the tax is no longer collected and the rate declines. A proportional tax would collect the same percentage of tax on the tax base, regardless of the size of the base. The sales tax is a proportional tax as the same percent tax is collected regardless of the amount spent. As of 2018, the corporate income tax is also a proportional tax.

19. [LO 1.2] *Income Tax Rates*

**Solution:** Individuals have basic tax rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37% that apply to their ordinary income and their interest income. The basic tax rates for their dividend income are 0%, 15%, and 20%. Corporations have no tax-favored incomes so they pay a flat tax rate of 21%.

20. [LO 1.2] *Income Tax Rates*

**Solution:** Individual's short-term capital gains tax rates are the same as the tax rates on ordinary income. An individual's long-term capital gains rates are 0%, 15%, and 20%.

21. [LO 1.3] *Canons of Taxation*

**Solution:** The basic idea of equity is that persons with similar incomes will face similar taxes. Thus, individuals each with \$200,000 in taxable income will pay the same amount of tax. A tax meets the criterion of economy when the amount of revenue it raises is at an optimum level after the costs of administration and compliance are considered. The canon of certainty would dictate that a taxpayer know with reasonable accuracy the tax consequences of a transaction at the time the transaction takes place. The last canon of convenience states that a convenient tax is one that would be readily determined and paid with little effort.

22. [LO 1.3] *Equity Concepts*

**Solution:** Horizontal equity would require persons with equal incomes pay equal amounts of taxes. Vertical equity would require persons with higher incomes to pay a higher percentage of their income than persons with lower incomes. This is the basis of the U.S. tax system.

#### 4 Solutions Manual for Taxation for Decision Makers

23. [LO 1.4] *Taxable Persons*

**Solution:** Only individuals, regular (or C) corporations, and fiduciaries (estates and trusts) pay income taxes.

24. [LO 1.4] *Gross Income*

**Solution:** The term gross income is an all-inclusive term that includes income from all sources that are not specifically excluded.

25. [LO 1.4] *Basic Tax Model*

**Solution:** The basic elements of the tax model are gross income, less deductions, that equal taxable income or loss. The applicable tax rate is applied to this to determine the gross tax liability. From this tax credits and prepayments are deducted to determine the tax liability owed or the refund due.

26. [LO 1.4] *Capital Losses*

**Solution:** An individual may deduct up to \$3,000 of capital losses in excess of capital gains annually; the excess may be carried forward indefinitely to succeeding years. A corporation can only offset capital losses against capital gains; losses are not deductible against other income. Instead the corporation first carries the losses back to the three previous years and then forward for 5 years.

27. [LO 1.4] *Basic Income Tax Rates*

**Solution:** Individuals have basic tax rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37% that are applied to their ordinary income. A corporation pays a flat tax rate of 21%.

28. [LO 1.4] *Fiduciaries*

**Solution:** Trusts and estates are two fiduciary entities; a trust is established by a grantor who appoints a trustee to manage the assets for the benefit of the trust's beneficiaries. An estate is an entity that is created on the death of a person that provides management for the assets in the decedent's estate until they can be distributed to the beneficiaries. A grantor is the person who creates the trust when assets are placed in the trust for the benefit of the beneficiaries. The trustee is the person selected by the grantor to oversee the assets and ensure the trust functions as specified by the grantor. The beneficiary of the trust is the person for whom the trust was established and who is to benefit from the income from the trust (an income beneficiary) or receive the assets when the trust is closed (the remainderman).

29. [LO 1.5] *Sole Proprietorships*

**Solution:** Only one taxable person, who must be an individual, can own a sole proprietorship. The sole proprietor is personally liable for all debts of the business. The sole proprietor cannot be an employee of the business and must pay self-employment tax. The results of operations of the sole proprietorship are reported on the Schedule C and these are then included in the owner's personal tax return. A partnership must have more than one owner. A general partner is liable for partnership debts but limited partners are only liable for their investment in the

partnership. Like sole proprietors, partners cannot be employees of the partnership and general partners are required to pay self-employment tax. Although partnerships do not pay taxes directly, they must file information tax returns. The income/loss from the partnership flows through to the partners and is reported on their own tax returns. Partners pay any taxes owing on the income items but loss is deductible only if a partner has sufficient basis. A partner's basis begins with his or her investment in the partnership and is increased for the partner's share of partnership liabilities.

Partnerships and limited liability companies differ in a number of ways. Owners of partnerships are partners while owners of limited liability companies are called members. There are no legal requirements to set up a partnership but a limited liability company must be established according to the laws of the state of domicile. Limited liability companies can elect to be taxed as corporations while partnerships do not have that option. In some states, a limited liability company may have only one owner but a partnership must have two or more owners. Only the managing members of a limited liability company may be subject to self-employment taxes.

30. [LO 1.5] *Corporations*

**Solution:** The principal difference between a C corporation and an S corporation is in the method of taxation. A C corporation pays a tax directly on its income. Any net after-tax income that is distributed to its shareholders as dividends is subject to a second level of tax. Thus, these corporate earnings are said to be subject to double taxation. An S corporation's income flows directly through to its shareholders (whether there is an actual distribution of this income in cash or not) undiminished by taxes at the corporate level. The income is then taxed once only at the shareholder level. The corporation can then make actual distributions of this previously-taxed income to the S corporation shareholders without any additional taxes due. There are a number of other differences in that the number and type of S corporation shareholders is limited; it can only have one class of stock outstanding, and its choice of tax year is restricted. None of these restrictions apply to a C corporation. Other items of comparison could be drawn from the table in the text comparing business entity attributes.

### Crunch the Numbers

31. [LO 1.1] *Property Taxes*

**Solution:** He will pay \$750.  $\$20,000,000 / \$4,000,000,000 = .005$  or 5 mills per \$1 of valuation.  $\$150,000 \times .005 = \$750$  in tax

32. [LO 1.1] *FICA Tax*

**Solution:**  $\$40,000 \times 7.65\% = \$3,060$

33. [LO 1.1] *FICA Taxes*

**Solution:** 9,990.80 is withheld for FICA taxes in 2018.

6 Solutions Manual for Taxation for Decision Makers

\$128,400 x 6.2% =	\$7,960.80
\$140,000 x 1.45% =	<u>2,030.00</u>
Total	\$9,990.80

34. [LO 1.4] *Taxable Income*

**Solution:** Taxable income = \$28,000

	\$40,000	Salary
Less	<u>12,000</u>	Standard deduction
	\$28,000	

35. [LO 1.4] *Taxable Income*

**Solution:** Taxable income = \$53,500

	\$71,000	Salary
Plus	1,500	Interest income
Less	<u>19,000</u>	Itemized deductions
	\$53,500	

36. [LO 1.4] *Taxable Income*

**Solution:** Taxable income = \$49,000

	\$450,000	Gross receipts
minus	<u>145,000</u>	Cost of goods sold
equals	\$305,000	Gross income
plus	20,000	Gain on sale
minus	<u>276,000</u>	Expenses
equals	\$49,000	Taxable income

The \$500 interest on State of New York bonds is tax-exempt.

37. [LO 1.4] *Taxable Income*

**Solution:** Taxable income = \$237,500

	\$560,000	Gross income
plus	2,500	Interest income
minus	<u>325,000</u>	Expenses
equals	\$237,500	Taxable income

The \$20,000 capital loss is not deductible currently.

38. [LO 1.4] *Taxable Income*

**Solution:** Taxable income = \$86,000

	George's salary	\$65,000
plus	Mary's salary	<u>45,000</u>
equals	Gross income	\$110,000
minus	Standard deduction	<u>24,000</u>
equals		\$ 86,000

The \$24,000 standard deduction is greater than their itemized deductions.

39. [LO 1.4] *Determining Tax Liability*

**Solution:** Taxable income = \$28,000; income tax = \$3,169.50.

$$\text{Income Tax: } [(\$28,000 - \$9,525) \times 12\%] + \$952.50 = \$3,169.50.$$

40. [LO 1.4] *Determining Tax Liability*

**Solution:** Taxable income = \$49,000; income tax = \$10,290.

$$\text{Income Tax: } \$49,000 \times 21\% = \$10,290.$$

41. [LO 1.4] *Determining Tax Liability*

**Solution:** Taxable income = \$237,500; Income tax = \$49,875.

$$\$237,500 \times 21\% = \$49,875$$

(The \$20,000 capital loss is not deductible currently.)

42. [LO 1.4] *Marriage Penalty*

**Solution:** Yes, they have a marriage penalty of \$2,000 (\$198,379 - \$196,379).

$$\text{MFJ: } [(\$700,000 - \$600,000) \times 37\%] + \$161,379 = \$198,379$$

$$\text{Single: } [(\$350,000 - \$200,000) \times 35\%] + \$45,689.50 = \$98,189.50 \times 2 = \$196,379$$

43. [LO 1.4] *Joint vs. Single Filing*

**Solution:** a. It will be to their advantage to marry in 2018.

b. By marrying before the end of 2018 and filing jointly, they save \$13,835.50 (\$55,214.50 - \$41,379) in taxes.

$$\text{MFJ: } [(\$220,000 - \$165,000) \times 24\%] + \$28,179 = \$41,379$$

$$\text{Single: } [(\$220,000 - \$157,500) \times 32\%] + \$32,089.50 = \$55,214.50$$

c. If they each have \$110,000 of income, they would each pay \$41,379 in taxes and there would be no marriage penalty.

$$\text{Tax on } \$110,000 \text{ (Single): } [(\$110,000 - \$82,500) \times 24\%] + \$14,089.50 = \$20,689.50$$

$$\$20,689.50 \times 2 = \$41,379.$$

44. [LO 1.4] *Income Tax Liability*

**Solution:** Taxable income = \$52,000.

\$76,000 salary and wages - \$24,000 standard deduction = \$52,000 taxable income.

The \$24,000 standard deduction is greater than their itemized deductions.

A tax credit reduces the tax liability but does not affect taxable income.

45. [LO 1.4] *Tax Liability*

**Solution:** The estate will pay \$5,786.50.

$$[\$20,000 - \$12,500] \times 37\% + \$3,011.50 = \$5,786.50.$$

46. [LO 1.5] *Tax Liability*

**Solution:** William's income is twice John's, but his taxes are 2.68 (\$9,139.50/\$3,409.50) times John's. This illustrates the progressive nature of the tax system as well as vertical equity.

$$[(\$30,000 - \$9,525) \times 12\%] + \$952.50 = \$3,409.50$$

8 Solutions Manual for Taxation for Decision Makers

$$[(\$60,000 - \$38,700 \times 22\%) + \$4,453.50 = \$9,139.50$$

47. [LO 1.5] *Determining Tax Liability*

**Solution:** The net tax liability is \$14,250.

$$\$250,000 \text{ gross income} - \$125,000 \text{ expenses} = \$125,000 \text{ taxable income.}$$

$$\text{The income tax liability is: } (\$125,000 \times 21\%) = \$26,250 \text{ gross tax}$$

$$\$26,250 - \$12,000 \text{ tax credit} = \$14,250 \text{ net tax}$$

48. [LO 1.5] *Determining Tax Liability*

**Solution:** Taxable income = \$27,000 and the tax liability is \$3,049.50

	\$46,000	Salary
minus	<u>7,000</u>	Partnership loss (50% x \$14,000)
equals	\$39,000	Gross income
minus	<u>12,000</u>	Standard deduction
equals	<u>\$27,000</u>	Taxable income

$$\text{Tax: } [(\$27,000 - \$9,525) \times 12\%] + \$952.50 = \$3,049.50$$

49. [LO 1.4 & 1.5] *Tax Liability Comparisons*

**Solution:** Partnership: Pays no tax. June and John are each taxed on the \$32,000 passed through to them at their marginal tax rates.

To determine their marginal tax rates, find the tax bracket in which their other taxable income falls. (Note that the “other ordinary taxable income” is provided; either the standard or their itemized deductions have already been subtracted.)

June’s \$600,000 of other ordinary taxable income puts her in the 37% marginal tax bracket because she is a head of household with taxable income over \$500,000.

John’s \$32,000 falls within the 24% marginal tax bracket (\$240,000 of taxable income plus the additional \$32,000 does not exceed \$315,000 – the 24% tax bracket). His \$32,000 is taxed at 24% for a married taxpayer filing a joint return.

$$\text{June’s tax} = \$32,000 \times 37\% = \$11,840.$$

$$\text{John’s tax} = \$32,000 \times 24\% = \$7,680.$$

Together they pay a total of \$19,520 in taxes.

S Corporation: Pays no tax. June and John are each taxed on the \$32,000 passed through to them at their marginal tax rates as shown above for the partnership and together they pay \$19,520 in taxes.

C Corporation: The corporation pays a tax of \$13,440

$$\$64,000 \times 21\% = \$13,440$$

Neither June nor John pay any taxes as they received no distributions from the corporation.

Note the problem specified only income taxes; employment taxes are not included in the solution to this problem.

50. [LO 1.4 & 1.5] *Tax Liability Comparisons*



**Solution:** Partnership: The answer does not change because June and John are taxed fully on their shares of income whether they are distributed or not and the partnership pays no tax. Thus, June's tax is still \$11,840 and John's tax is \$7,680 for a total of \$19,520 in taxes. They pay no additional tax on the \$28,000 distribution.

S Corporation: The answer does not change because June and John are taxed fully on their shares of income whether they are distributed or not and the S corporation pays no tax. Thus, June's tax is still \$11,840 and John's tax is \$7,680 for a total of \$19,520 in taxes. They pay no additional tax on the \$28,000 distribution.

C Corporation: The corporation pays the same tax of \$13,440 ( $\$64,000 \times 21\%$ ). June and John, however, will now have to recognize \$28,000 of dividend income; John will be taxed at the 15% dividend rate but June will be taxed at 20% (the dividend rate for a head of household with over \$452,400 of taxable income).

June's tax =  $\$28,000 \times 20\% = \$5,600$ .

John's tax =  $\$28,000 \times 15\% = \$4,200$ .

The total tax for the corporation, June, and John is \$23,240 ( $\$13,440 + \$5,600 + \$4,200$ ).

Note the problem specified only income taxes; Medicare surtaxes and employment taxes are not included in the solution to this problem.

51. [LO 1.4 & 1.5] *Tax Liability Comparisons*

**Solution:** Partnership: The partnership does not benefit from the loss. June and John are each allocated \$22,000 of loss and can deduct the loss against their other income because they have sufficient basis in the partnership [ $\$20,000$  invested + ( $\$30,000$  bank loan  $\times 50\%$ ) =  $\$35,000$  basis before loss -  $\$22,000$  loss =  $\$13,000$  ending basis]. June's and John's incomes are high enough for them to remain fully in their respective marginal tax rates of 37% and 24%. June benefits from a reduction in taxes of \$8,140 ( $\$22,000 \times 37\%$ ) and John saves \$5,280 ( $\$22,000 \times 24\%$ ) in taxes at his marginal tax rate. The total tax savings for both are \$13,420 ( $\$8,140 + \$5,280$ ).

S Corporation: The S corporation does not benefit from the loss. June and John are each allocated \$22,000 of the loss but they can only deduct \$20,000 of this loss against their other income because their deduction is limited to their basis in their S corporation stock (which does not include any of the corporation's liabilities). Thus, June benefits from a reduction in taxes of \$7,400 ( $\$20,000 \times 37\%$ ) at her marginal tax rate. John reduces his taxes by \$4,800 ( $\$20,000 \times 24\%$ ) at his marginal tax rate. They will each carry their excess \$2,000 loss forward; these losses can be deducted in a future year when they have sufficient basis. The total tax savings for the current year is \$12,200 ( $\$7,400 + \$4,800$ ).

C Corporation: Neither June nor John have any current tax savings from the \$44,000 loss. As a new corporation, it can only carry its loss forward to offset income (and realize tax savings) in a future year. Losses of a C corporation do not pass through to shareholders.

Note the problem specified only income taxes; Medicare surtaxes and employment taxes were not included in the solution.

52. [LO 1.4 & 1.5 *Choice of Business Entity*]

**Solution:** a. (1) The partnership does not pay any tax in years 1 or 2.

(2) The S corporation does not pay any tax in years 1 or 2.

(3) The C corporation pays no tax in year 1 but its year-1 loss can be carried forward to year 2 to offset \$54,000 of its year-2 \$60,000 income; it will pay a tax of \$1,260 ( $\$6,000 \times 21\%$ ) on this remaining \$6,000 income in year 2.

b. (1) Tax savings for first year of partnership: Clara and Charles are each allocated \$27,000 of loss and each can deduct \$25,000 of the loss (the extent of basis [ $\$15,000$  investment +  $(50\% \times \$20,000$  loan)]. Clara's tax savings will be \$8,750 ( $\$25,000$  deductible loss  $\times 35\%$ ) and Charles's tax savings will be \$6,000 ( $\$25,000$  deductible loss  $\times 24\%$ ). The excess loss is carried forward to the next year.

Partner's basis computations:

\$15,000	Partner's original investment
<u>+10,000</u>	Partner's share of liabilities ( $\$20,000$ loan $\times 50\%$ )
\$25,000	Basis before deducting loss
<u>- 25,000</u>	Deductible loss ( $\$54,000$ loss $\times 50\% = \$27,000$ but limited to basis and \$2,000 excess loss carried forward)
0	Basis at end of first year

(2) Tax savings for first year of S corporation: Clara and Charles are each allocated \$27,000 of loss and can deduct loss to the extent of the basis in the S corporation stock. Clara's tax savings will be \$5,250 ( $\$15,000$  deductible loss  $\times 35\%$ ) and Charles's savings will be \$3,600 ( $\$15,000$  deductible loss  $\times 24\%$ ).

S corporation shareholder's stock basis computations:

\$15,000	Shareholder's original investment
<u>-15,000</u>	Deductible loss ( $\$54,000$ loss $\times 50\% = \$27,000$ but limited to basis and \$12,000 excess loss carried forward)
0	Basis at end of first year

Note that an S corporation shareholder does not increase stock basis for any corporate liabilities.

(3) First year of C corporation: No effect on Clara or Charles. Their basis in stock remains \$15,000 each.

c. (1) Income tax for second year of partnership: Clara pays \$9,800 income tax [ $(\$30,000$  profit -  $\$2,000$  loss carried forward)  $\times 35\%$ ] and Charles pays \$6,720 income tax [ $(\$30,000$  profit -  $\$2,000$  loss carried forward)  $\times 24\%$ ]. The cash distribution is not taxed but is a reduction of basis.

Partner's basis computations:

0	Basis at end of first year
\$30,000	Year 2 profit ( $\$60,000 \times 50\%$ )
<u>- 5,000</u>	Cash distribution

\$25,000	Subtotal
- 2,000	Deduct loss carried forward from previous year
\$23,000	Basis at end of second year

(2) Income tax for second year of S corporation: Clara pays \$6,300 in tax [(\$30,000 profit - \$12,000 loss carried forward) x 35%] and Charles pays \$4,320 tax [(\$30,000 profit - \$12,000 loss carried forward) x 24%]. The cash distribution is not taxed but is a reduction of basis.

S corporation shareholder's stock basis computations:

0	Basis at end of first year
\$30,000	Year 2 profit (\$60,000 x 50%)
- 5,000	Cash distribution
\$25,000	Subtotal
- 12,000	Deduct loss carried forward from previous year
\$13,000	Basis at end of second year

(3) Income tax for second year of C corporation: Clara and Charles each pay \$750 tax on their dividend income (\$5,000 dividend income x 15% dividend rate = \$750 tax). Their basis in the corporate stock remains \$15,000.

53. [LO 1.5] *Partnership Basis*

**Solution:** His basis is \$5,200.

$\$4,000 \text{ beginning basis} + (30\% \times \$7,000 \text{ partnership income}) - (30\% \times \$3,000 \text{ distribution}) = \$4,000 + \$2,100 - \$900 = \$5,200$

### Develop Planning Skills

54. [LO 1.4] *Single vs. Married Filing Status*

**Solution:**

Married Filing Separately:  $[(\$360,000 - \$300,000) \times 37\%] + \$80,689.50 = \$102,889.50$

$\$102,889.50 \times 2 = \$205,779$

Married Filing Jointly:  $[(\$720,000 - \$600,000) \times 37\%] + \$161,379 = \$205,779$

Single:  $[(\$360,000 - \$200,000) \times 35\%] + \$45,689.50 = \$101,689.50 \times 2 = \$203,379$

It makes no difference if they marry this year and file either as married filing jointly or separately. If they postpone the wedding until next year, they will save \$2,400 ( $\$205,779 - \$203,379$ ) in taxes filing as single individuals this year.

55. [LO 1.4 & 1.5] *Total Tax Comparison*

**Solution:** Sole Proprietorship: Jeremy will be taxed on the entire net income from the sole proprietorship of \$68,000 ( $\$80,000 - \$12,000$ ) regardless of the "salary."  $\$68,000 - \$12,000 \text{ standard deduction} = \$56,000 \text{ taxable income}; [22\% \times (\$56,000 - \$38,700)] + \$4,453.50 = \$8,259.50 \text{ income tax.}$

## 12 Solutions Manual for Taxation for Decision Makers

Corporation:  $\$80,000 - \$12,000 - \$30,000 = \$38,000$  taxable income;  $\$38,000 \times 21\% = \$7,980$  corporate income tax. Income tax on Jeremy's  $\$30,000$  salary: Jeremy's taxable income =  $\$30,000 - \$12,000$  standard deduction =  $\$18,000$ . Tax on  $\$18,000 = \$952.50 + [(\$18,000 - \$9,525) \times 12\%] = \$1,969.50$ . Total taxes as a corporation =  $\$7,980 + \$1,969.50 = \$9,949.50$

Based solely on income taxes, Jeremy should not incorporate because his taxes will be  $\$1,690$  ( $\$9,949.50 - \$8,259.50$ ) more than operating as a sole proprietorship.

### 56. [LO 1.1, 1.4 & 1.5] *Form of Business Operations: C Corporation vs. S Corporation*

**Solution:** Regular C Corporation: FICA tax on Carol's  $\$60,000$  salary is  $\$4,590$  ( $\$60,000 \times 7.65\%$ ). FUTA =  $\$420$  ( $\$7,000 \times 6\%$ )

Corporate taxable income =  $\$200,000 - \$75,000 - \$60,000$  salary -  $\$4,590$  FICA -  $\$420$  FUTA =  $\$59,990$ .

Income tax on  $\$59,990 = \$59,990 \times 21\% = \$12,597.90$ .

Total corporate taxes =  $\$4,590 + \$420 + \$12,597.90 = \$17,607.90$ .

Carol's taxes: Carol also pays  $\$4,590$  ( $\$60,000 \times 7.65\%$ ) in FICA taxes on her salary but she cannot deduct these taxes.

Carol's taxable income =  $\$60,000 - \$12,000$  standard deduction =  $\$48,000$ .

Income tax:  $(\$48,000 - \$38,700) \times 22\% + \$4,453.50 = \$6,499.50$ .

Carol's total taxes =  $\$6,499.50 + \$4,590 = \$11,089.50$ .

Total taxes =  $\$17,607.90 + \$11,089.50 = \$28,697.40$

S Corporation: FICA tax on Carol's  $\$60,000$  salary is  $\$4,590$  ( $\$60,000 \times 7.65\%$ ). FUTA =  $\$420$  ( $\$7,000 \times 6\%$ ).

The net S corporation income of  $\$59,990$  (same as the regular corporation) is passed through to Carol for taxation along with her salary income.

Carol's taxable income =  $\$60,000$  salary +  $\$59,990$  corporation income -  $\$12,000$  standard deduction =  $\$107,990$ .

Tax on Carol's  $\$107,990$  taxable income =  $[(\$107,990 - \$82,500) \times 24\%] + \$14,089.50 = \$20,207.10$

Carol's total tax =  $\$20,207.10 + \$4,590 = \$24,797.10$

Total taxes =  $\$24,797.10 + \$4,590 + \$420 = \$29,807.10$

Based on 2018 total taxes only, Carol should not make the S corporation election because the total taxes will be  $\$1,109.70$  ( $\$29,807.10 - \$28,697.40$ ) less operating as a regular C corporation.

### Think Outside the Text

*These questions require answers that are beyond the material that is covered in this chapter.*

### 57. [LO 1.2] *Tax Rates*

**Solution:**

<u>Income Tax Rate on salary</u>	<u>Employment Tax Rate</u>	<u>Capital Gains Tax Rate</u>
12%	7.65%	0%
24%	6.2% up to \$128,400 and 1.45% on \$132,000	15%
32%	6.2% up to \$128,400 and 1.45% on \$176,000 salary	15% on \$139,000*
35%	6.2% up to \$128,400; 1.45% on \$285,000*	15% on the first \$140,800 (up to taxable income of \$425,800) and 20% on remaining \$107,200*

\*excluding Medicare surtaxes

58. [LO 1.2] *Tax Fairness*

**Solution:** No answer is suggested here as the purpose of this question is to require the student to select an alternative and construct an argument to support that position.

59. [LO 1.2] *Property Tax*

**Solution:** As an ad valorem tax, a property tax is proportional. If you use another tax base except the value of the property, the tax may be progressive for some group of citizens and regressive for others. For example, senior citizens generally have lower incomes than working persons. They may have lived in their home a long time and paid off the mortgage. If it had significantly appreciated (with property tax increases), based on a percentage of their income, the property tax would be regressive. Alternatively, a lower income person may spend only 25 percent of his or her income on housing because of other necessities. A high-income person may be able to spend 40 percent of his or her income on housing. The latter's property taxes will be much higher as a percent of income than the former. In this situation, the tax is progressive when based on income. Thus, for a wealth tax such as a property tax, wealth is the only base on which it is practical to evaluate it. It is generally proportional, although a certain base amount may be excluded from the tax (for example, a \$25,000 homestead exemption for persons who own their own home would make it somewhat progressive).

60. [LO 1.2] *Flat Tax*

**Solution:** Although the corporate tax rate is now a flat 21%, most students will agree that there will have to be some basic exclusions or deductions to enact a viable flat tax for individuals. Comparisons can also be drawn to the FICA taxes which have been flat over incomes up to the Social Security base amount (\$128,400 for 2018), but only the Medicare portion applies above this base amount. Discussions of a flat tax can often lead to discussions of higher minimum wages, guaranteed annual incomes, and negative income taxes in order to keep the flat tax relatively simple.

61. [LO 1.3] *Tax Evaluation Using the Canons of Taxation*

**Solution:** The four canons of taxation are equity, economy, certainty, and convenience. In

general, with the exception of an evaluation based on equity, many persons believe the sales tax that most states levy is superior to the income tax. The costs to collect and comply with the sales tax are relatively small compared to the amounts collected (although internet sales are a significant problem now); most persons know that when they purchase certain items they are required to pay sales taxes; *and* they pay at the point of sale without having to file end-of-year returns. Sales taxes are considered regressive, however, and therefore not considered equitable. As a percentage of income, lower income persons pay more sales tax than higher income persons do because they are obliged to spend more of their income. As an absolute amount, however, most wealthy persons spend more overall than poor persons, and, as a result pay more sales taxes (vertical equity). Two persons with equal incomes can pay different amounts of sales taxes, however, if one party chooses to save money while the other spends; this would violate horizontal equity. The income tax has far higher costs of collections and administration but its tax rates are progressive and it contains provisions that exempt low-income taxpayers from paying any taxes. Thus, it is generally seen as more equitable than a sales tax. It fails, however, on convenience and certainty because of the annual filing requirements and constant changing of the laws.

62. [LO 1.4] *Marriage Penalty*

**Solution:** An evaluation of this proposal at this point usually focuses on the cost to the taxpayer in time and money to determine the tax under the dual system. Other problems arise in the dividing up of itemized deductions and tax credits. If taxpayers are allowed to choose the method that allows them to pay the lower tax, there will also be a decline in total tax revenues. To some degree taxpayers have a choice now – but the difference in tax rates from single to married filing separately and the requirement that both must either choose the standard deduction or itemize deductions limits their “gaming the system.”

63. [LO 1.4] *After-Tax Interest Rate*

**Solution:** The interest rate = 5.53%.

The \$7,000 interest ( $\$100,000 \times 7\%$ ) would reduce taxes by \$1,470 ( $\$7,000 \times 21\%$ ). Thus the net interest paid is \$5,530 ( $\$7,000 - \$1,470$ ). The after-tax interest rate is 5.53% ( $\$5,530/\$100,000$ ). Alternatively, this can be calculated directly as  $7\% (1 - .21) = 5.53\%$

64. [LO 1.4] *Deductions vs. Credits*

**Solution:** Taxable income = \$50,000; marginal tax bracket = 22%. Tax savings from the \$4,000 deduction = \$880 ( $22\% \times \$4,000$ ).

Taxable income = \$200,000; marginal tax bracket = 32%. Tax savings from the \$4,000 deduction = \$1,280 ( $32\% \times \$4,000$ ).

A \$4,000 tax credit reduces each taxpayer’s tax by \$4,000. The tax savings from a tax credit is independent of the taxpayer’s marginal tax rate.

**Search the Internet**

For the following four problems, consult the IRS website ([www.irs.gov](http://www.irs.gov)).

*Check solutions*

65. [LO 1.1] *Statistical Information*

**Solution:** There are links to a wide range of tables, articles, and data that describe and measure elements of the U.S. tax system. These include statistics and other information about returns filed with the IRS. Headings under this section include: Business Tax Statistics; Individual Tax Statistics; IRS Operations & Budget; Statistics of Income (SOI); Charitable & Exempt Org. Statistics; Products, Publications, & Papers; Statistics by Form; Other IRS Data and Research, and Additional Information.

66. [LO 1.1] *Statistics of Income*

**Solution:** About SOI, Dissemination Policy, SOI Products and Services, SOI Data Releases, Statistical Methodology, and All Topics

67. [LO 1.1] *Volunteer Income Tax Assistance Program*

**Solution:** The Volunteer Income Tax Assistance (VITA) program offers free help to people who generally make \$54,000 or less, persons with disabilities, and limited English speaking taxpayers who need assistance in preparing their own tax returns. IRS-certified volunteers provide free basic income tax return preparation.

68. [LO 1.1] *Law Enforcement Assistance Program*

**Solution:** LEAP is the Law Enforcement Assistance Program. Federal law generally prohibits the IRS from disclosing any taxpayer information. LEAP allows victims of identity theft to sign a waiver permitting the IRS to disclose fraudulent tax return information to state or local police.

69. [LO 1.1] *Tax Freedom Day*

**Solution:** (a) Tax Freedom Day is the specific day in the year that, on average, Americans stop working to pay the government; that is, income to that date all goes to pay taxes; income for the rest of the year belongs to the taxpayer to do with as he or she chooses. (b) Tax Freedom Day was April 24 in 2016 and April 23 in 2017. Thus, 114 days in 2016 and 113 days in 2017 were worked to pay taxes. This date varies greatly when done on a state-by-state basis.

**Identify the Issues**

*Identify the issues or problems suggested by the following situations. State each issue as a question.*

70. [LO 1.4] *Filing Status*

**Solution:** What is John and Mary's filing status for the current year?

71. [LO 1.5] *S Corporation Requirements*

**Solution:** Is the S corporate restriction of no more than 100 shareholders violated when John gives half of his shares to his wife? Will its S election terminate?

72. [LO 1.5] *Disguised Dividend*

**Solution:** Will all of Clifford's salary be deductible by the corporation as salary or is it possible that a portion of it will be declared a disguised dividend?



## Chapter 1 Summary of End-of-Chapter Problem Revisions

2019 Edition Problem Number	2018 Edition Problem Number	2019 Edition Modifications
1	1	
2	2	
3	3	
4	4	
5	5	
6	6	
7	7	
8	8	
9	9	
10	10	
11	11	
12	12	
13	13	
14	14	
15	15	
16	16	
17	17	Problem updated & solution modified
18	18	Solution updated
19	19	Solution updated
20	20	Problem & solution modified
21	21	
22	22	
23	23	
24	24	
25	25	
26	26	
27	27	Solution updated
28	28	
29	29	
30	30	
31	31	
32	32	Year updated
33	33	Year updated & solution updated
34	34	Year updated & solution updated
35	35	Problem & solution modified
36	36	
37	37	
38	38	Problem & solution modified
39	39	Year updated & solution updated
40	41	Solution updated
41	42	Solution updated

## 2 Solutions Manual for Taxation for Decision Makers

42	43	Problem & solution modified
43	44	Problem & solution modified
44	45	Problem & solution modified
45	46	Year updated & solution updated
46	49	Solution updated
47	51	Solution updated
48	52	Year updated & solution updated
49	53	Problem & solution modified
50	54	Problem & solution modified
51	55	Problem & solution modified
52	56	Problem & solution modified
53	57	
54	58	Problem & solution modified
55	59	Year updated & solution updated
56	60	Year updated & solution updated
57	61	Year updated & solution updated
58	62	
59	63	
60	64	Problem & solution modified
61	65	
62	66	Solution updated
63	67	Problem & solution modified
64	68	Solution updated
65	69	Solution updated
66	71	
67	-	New problem
68	-	New problem
69	73	Year updated & solution updated
70	74	
71	75	
72	76	
	40	Problem deleted
	47	Problem deleted
	48	Problem deleted
	50	Problem deleted
	70	Problem deleted
	72	Problem deleted

## Chapter 2

# The Tax Practice Environment

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### Solutions to Develop Research Skills

Note to Instructor: Many of the research problems can be solved using sources that are available on the Internet at no charge. URLs for these free sources are shown in Figure 2.1 of Chapter 2 in the text. The solution for each problem indicates if it can be solved using free Internet sources or if it requires access to *Checkpoint*® or a similar service. Suggested research aids are included as part of the problem information only for this chapter. For all remaining chapters, the suggested research aids are included only as part of the solution to each problem to allow instructors to choose whether or not to provide any hints to students for a particular problem.

76. [LO 2.4] *Deducting Cosmetic Surgery (can be solved using free Internet sources)*

Your client, Ms. I.M. Gorgeous, is an aspiring actress. She has managed to earn a living doing television commercials but was unable to get the acting parts she really wanted. She decided to have botox injections in her forehead and collagen enhancements to her lips. After these procedures, her career improved dramatically and she received several movie offers. Ms. Gorgeous is sure that she should be able to deduct the cost of the cosmetic enhancements because she read about another actress having a face-lift in 1988 and deducting the cost on her tax return as a medical expense. Can Ms. Gorgeous deduct the cost of these procedures?

*Research Aid:* Section 213(d)(9).

**Issue:** Can Ms. Gorgeous deduction the cost of the botox injections and collagen enhancements as medical expenses?

**Conclusion:** Ms. Gorgeous will not be allowed to deduct the cost of botox injections and collagen enhancements.

**Discussion of Reasoning and Authorities:** Code Section 213 allows a deduction for expenses paid for medical care of the taxpayer. Section 213(d)(1)(A) defines medical care as amounts paid “for the diagnosis, cure, mitigation, treatment, or prevention of disease or for the purpose of affecting any structure or function of the body.”

Rev. Rul. 76-332, 1976-2 C.B. 81 allowed a deduction for cosmetic surgery for a face-lift under Section 213. However, the Code was subsequently amended by the Revenue Reconciliation Act of 1990.

Under §213(d)(9)(A), no deduction is allowed for cosmetic surgery or other similar procedures, unless the surgery or procedure is necessary to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or disfiguring disease. Section 213(d)(9)(B) defines cosmetic surgery as any procedure which is directed at improving personal appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease. Thus, no deduction will be allowed.

77. [LO 2.4] *Deducting Bad Debt Loss (can be solved using free Internet sources)*

Last year your client, Barney Bumluck, worked part-time for Timely Tax Return Preparation Service. Barney was promised an hourly wage plus a commission. He worked under this arrangement from early February until April 15. His accrued pay amounted to \$900 plus \$120 of commissions. When he went to collect his pay, however, he found only a vacant office with a sign on the door reading “Nothing is sure but death and taxes.” Can Barney take a bad debt deduction for the wages and commission he was unable to collect?

*Research Aid:* Reg. Section 1.166-1(e)

## 2 Taxation for Decision Makers Research Solutions

**Issue:** Can Barney take a bad debt deduction for the wages and commission he was unable to collect?

**Conclusion:** Barney will not be permitted a deduction since the wages and commission were not previously included in his return as income.

**Discussion of Reasoning and Authorities:** Under Reg. §1.166-1(e), worthless debts arising from unpaid wages, salaries, fees, rents, and similar items of taxable income shall not be allowed as a deduction unless the income has been included in the return of income for the year for which the deduction as bad debt is claimed or for a prior taxable year. Because Barney did not previously include the wages or commission in income, he is not entitled to a deduction for his inability to collect these items.

78. [LO 2.4] *Deducting Charitable Contributions (can be solved using Checkpoint® or a similar service)*  
Your clients, Sonny and his wife Honey, believe in worshipping Ta-Ra, the Sun God. To practice their religious beliefs, they take a weeklong trip to Hawaii to worship Ta-Ra. The cost of this pilgrimage (including airfare, hotel, and meals) is \$2,800. Sonny wants to know if he can deduct the cost of this trip as a charitable contribution to his religion.

**Note to Instructor:** No research aid is provided in the textbook for this problem. This allows you to choose whether or not to provide any hints to your students.

*Research Aids:* *Kessler*, 87 T.C. 1285 (1986)

**Issue:** Can Sonny and Honey deduct their trip to Hawaii as a charitable contribution made in the practice of their religion?

**Conclusion:** No deduction will be allowed because no donation was made directly to a qualified charitable organization.

**Discussion of Reasoning and Authorities:** In *Kessler*, 87 T.C. 1285 (1986), the Tax Court disallowed a charitable deduction for the expenses incurred for a trip to Puerto Rico. The Court denied the deduction because there was no donation made to a religious organization as defined by Code §170(c)(2)(B). The Court based its decision on precedent and Congressional intent stating that the purpose of the charitable contribution can only be furthered if the government can be assured that the funds are appropriately expended. This can be done only if contributions are made to a qualified organization that can be audited and examined. Since Sonny and Honey's expenses were not contributions or gifts to an organized entity, the expenses do not qualify under §170 as a charitable contribution.

79. [LO 2.4] *Trade or Business versus Hobby (can be solved using Checkpoint® or a similar service)*  
Fred Fisher is a licensed scuba diver who lives in Key Largo. He is employed full-time as an engineer. Five years ago he had been employed as a professional diver for a salvage company. While working for the salvage company he became interested in marine archaeology and treasure hunting. Until last year he gave diving lessons on weekends and trained individuals in the sport of treasure hunting under the name of "Fred's Diving School." Three of the diving students he taught subsequently found shipwrecks. Fred generally did not engage in recreational diving.

Last year, Fred began a treasure hunting business named "Treasure Seekers Company." He bought a boat specifically designed for treasure hunting and did extensive research on potential locations of shipwrecks. Fred located several shipwrecks, but none were of substantial value. He did retrieve several artifacts but has not sold any yet. Although these artifacts may have some historical significance, they have a limited marketability. Thus, Fred has not yet had any gross income from his treasure hunting activities.

Other than retaining check stubs and receipts for his expenses and an encoded log, Fred did not maintain formal records for Treasure Seekers Company. Fred maintains as few written records as possible because he fears for his safety. He took steps to keep his boat and equipment from public view and took precautionary measures to maintain the secrecy of his search areas. Fred incurred

\$5,000 of expenses relating to his treasure-hunting activities last year. Can Fred deduct the expenses of his treasure hunting business or will the IRS claim it is a hobby and disallow the expenses?

**Note to Instructor:** No research aid is provided in the textbook for this problem. This allows you to choose whether or not to provide any hints to your students.

*Research Aids:* *Randy R. Reed, III*, T.C. Memo 1988-470, 56 TCM. 363, PH T.C. Memo ¶88470 and Reg. §1.183-2(b)(1)-(9)

**Issue:** Can Fred deduct the expenses of his treasure hunting as business expenses?

**Conclusion:** Yes, Fred should be able to deduct his expenses as trade or business expenses.

**Discussion of Reasoning and Authorities:** Section 162 allows a deduction for business expenses that are ordinary, necessary, and reasonable in amount. Reg. §1.183-2(b)(1)-(9) lists a number of factors that should be considered in determining whether an activity is a trade or business, or should be classified as a hobby. These include:

- (1) Manner in which the taxpayer carries on the activity.
- (2) The expertise of the taxpayer or his advisors.
- (3) The time and effort expended by the taxpayer in carrying on the activity.
- (4) Expectation that assets used in the activity may appreciate in value.
- (5) The success of the taxpayer in carrying on other similar or dissimilar activities.
- (6) The taxpayer's history of income or losses with respect to the activity.
- (7) The amount of occasional profits, if any, which are earned.
- (8) The financial status of the taxpayer.
- (9) Elements of personal pleasure or recreation.

The Tax Court's decision in *Randy Reed III*, T.C. Memo 1988-470, 56 CCH T.C.M. 363, PH T.C. Memo ¶88,470 (1988) examines a situation very similar to that of Fred Fisher. In this case, a treasure hunter was an experienced diver and had personally trained other divers in the field of treasure hunting. His diving did not appear motivated by recreational intentions. He kept a checkbook separate from his personal account, maintained receipts and check stubs for his expenditures and kept a partial log book of his activities until his maps were stolen. Reed said that he kept limited records for security reasons. While not extensive, these records were held to be adequate for a sole practitioner in this type of business with a low volume of transactions, and Reed was allowed to deduct his expenses as those of a trade or business. In that the facts pertaining to Fisher's situation are nearly identical to Reed's, Fisher should be able to deduct the expenses of his treasure hunting business as valid business expenses.

80. [LO 2.4] *Locate and Read Court Case (can be solved using free Internet sources)*

Locate and read *Greg McIntosh*, TC Memo 2001-144, 81 TCM 1772, RIA TC Memo ¶2001-144 (6/19/2001). Answer the following questions.

- a. What requirements must be met for a taxpayer to recover litigation costs from the IRS?
- b. Was the taxpayer in this case able to recover his attorney fees from the IRS? Why or why not?

**Solution:**

- a. Under Code Section 7430(a), a judgment for litigation costs incurred in connection with a court proceeding may be awarded only if a taxpayer: (1) is the "prevailing party"; (2) has exhausted his or her administrative remedies within the IRS; and (3) did not unreasonably protract the court proceeding. To be a prevailing party, the taxpayer must substantially prevail with respect to either the amount in controversy or the most significant issue or set of issues presented and satisfy the applicable net worth requirement.
- b. The taxpayer was not able to recover his attorney fees from the IRS because he was not found to be the "prevailing" party. In this case, the court found that the IRS's positions on the disputed issues were reasonable positions sufficiently supported by the facts and circumstances in the taxpayer's case and the existing legal precedent. Since the IRS's

#### 4 Taxation for Decision Makers Research Solutions

positions were found to have been reasonable, the court could not find the taxpayer to be the “prevailing” party.

This decision was affirmed in 91 AFTR 2d 2003-1275, 2003-1 USTC ¶50,334 (CA9, 3/7/2003)

81. [LO 2.4] *Locate and Analyze Court Cases (can be solved using free Internet sources)*

Locate and read the following two cases:

*J.B.S. Enterprises, Inc.*, T.C. Memo 1991-254, 61 TCM. 2829, 1991 PH T.C. Memo ¶91,254

*Summit Publishing Company, Inc.*, T.C. Memo 1990-288, 59 TCM. 833, 1990 PH T.C. Memo ¶90,288

List those facts that you feel most influenced the judges to reach different conclusions in these two cases.

**Solution:**

<u>Facts</u>	<u>J.B.S. Enterprises</u>	<u>Summit Publishing</u>
Person who received salary	Former spouse of sole shareholder	Spouse of sole shareholder
Services performed for salary	None	Extensive valuable services
Dividend history	Not mentioned	Substantial dividends paid

The court allowed a deduction for expenses in Summit Publishing for a portion of the payments that the IRS argued were unreasonable compensation. The Court noted how valuable the shareholder’s spouse’s services were to the firm and that dividends had been paid to the shareholder. In *J.B.S. Enterprises*, the sole shareholder seemed to be attempting to disguise support payments made to his former wife as salary expense. However, she performed no services for which compensation would normally be paid.

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

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

Your first name and initial Pierre Last name Lappin Your social security number 1 2 3 4 6 6 7 8 9

If a joint return, spouse's first name and initial Jeannie Last name Lappin Spouse's social security number 4 4 5 6 7 9 8 7 8

Home address (number and street). If you have a P.O. box, see instructions. Apt. no. **▲** Make sure the SSN(s) above and on line 6c are correct.

123 Cottontail Lane

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). **Presidential Election Campaign**

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

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

**Filing Status**

1  Single

2  Married filing jointly (even if only one had income)

3  Married filing separately. Enter spouse's SSN above and full name here. ▶

4  Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶

5  Qualifying widow(er) (see instructions)

Check only one box.

**Exemptions**

6a  Yourself. If someone can claim you as a dependent, do not check box 6a . . . . .

b  Spouse . . . . .

**Boxes checked on 6a and 6b** 2

**c Dependents:**

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>
				<input type="checkbox"/>

If more than four dependents, see instructions and check here

**No. of children on 6c who:**

- lived with you
- did not live with you due to divorce or separation (see instructions)

**Dependents on 6c not entered above**

**Add numbers on lines above** 2

d Total number of exemptions claimed . . . . .

**Income**

7	Wages, salaries, tips, etc. Attach Form(s) W-2 . . . . .	7	<u>70,000</u>
8a	Taxable interest. Attach Schedule B if required . . . . .	8a	<u>3,000</u>
b	Tax-exempt interest. Do not include on line 8a . . . . .	8b	<u>2,000</u>
9a	Ordinary dividends. Attach Schedule B if required . . . . .	9a	<u>5,000</u>
b	Qualified dividends . . . . .	9b	<u>5,000</u>
10	Taxable refunds, credits, or offsets of state and local income taxes . . . . .	10	
11	Alimony received . . . . .	11	
12	Business income or (loss). Attach Schedule C or C-EZ . . . . .	12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/> . . . . .	13	<u>4,000</u>
14	Other gains or (losses). Attach Form 4797 . . . . .	14	
15a	IRA distributions . . . . .	15a	
b	Taxable amount . . . . .	15b	
16a	Pensions and annuities . . . . .	16a	
b	Taxable amount . . . . .	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E . . . . .	17	<u>10,000</u>
18	Farm income or (loss). Attach Schedule F . . . . .	18	
19	Unemployment compensation . . . . .	19	
20a	Social security benefits . . . . .	20a	
b	Taxable amount . . . . .	20b	
21	Other income. List type and amount . . . . .	21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your total income ▶	22	<u>92,000</u>

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

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

**Adjusted Gross Income**

23	Educator expenses . . . . .	23	
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ . . . . .	24	
25	Health savings account deduction. Attach Form 8889 . . . . .	25	
26	Moving expenses. Attach Form 3903 . . . . .	26	
27	Deductible part of self-employment tax. Attach Schedule SE . . . . .	27	
28	Self-employed SEP, SIMPLE, and qualified plans . . . . .	28	
29	Self-employed health insurance deduction . . . . .	29	
30	Penalty on early withdrawal of savings . . . . .	30	
31a	Alimony paid b Recipient's SSN ▶ <u>3 4 5 6 7 8 8 9 9</u> . . . . .	31a	<u>5,000</u>
32	IRA deduction . . . . .	32	
33	Student loan interest deduction . . . . .	33	
34	Tuition and fees. Attach Form 8917 . . . . .	34	
35	Domestic production activities deduction. Attach Form 8903 . . . . .	35	
36	Add lines 23 through 35 . . . . .	36	<u>5,000</u>
37	Subtract line 36 from line 22. This is your adjusted gross income ▶	37	<u>87,000</u>