Pearsons Federal Taxation 2018 Individuals 31st edition Pope Solutions Manual

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Chapter I:2

Determination of Tax

Discussion Questions

I:2-1 a. Gross income is income from taxable sources. Form 1040 combines the results of computations made on several separate schedules. For example, income from a proprietorship is reported on Schedule C where gross income from the business is reduced by related expenses. Only the net income or loss computed on Schedule C is carried to Form 1040. This is procedurally convenient but means gross income is not shown on Form 1040.

b. Gross income is relevant to certain tax determinations. For example, whether a person is required to file a tax return is based on the amount of the individual's gross income. As the amount does not necessarily appear on any tax return, it may be necessary to separately make the computation in order to determine whether a dependency exemption is available.

pp. I:2-3 through I:2-5.

I:2-2 The term "income" includes all income from whatever source derived, based on principles of economics and/or accounting. Gross income refers only to income from taxable sources; it does not include tax-exempt income. p. I:2-3.

I:2-3 a. A deduction is an amount that is subtracted from gross income (or adjusted gross income), while a credit is an amount that is subtracted from the tax itself.

b. In general, a $10 credit is worth more than a $10 deduction because the credit results in a $10 tax savings. The savings from a deduction is less than 100% of $10, depending on the tax bracket that applies to the taxpayer.

c. If a refundable credit exceeds the taxpayer's tax liability, the taxpayer will receive a refund equal to the excess. In the case of nonrefundable credits, the taxpayer will not receive a refund, but may be entitled to a carryover or carryback. pp. I:2-4 through I:2-6.

I:2-4 A dependent must be a qualifying child or a qualifying relative:

- A qualifying child must (1) be the taxpayer's child or sibling, (2) be under 19, a full-time student under 24, or disabled, (3) live with the taxpayer, and (4) not be self-supporting.
- A qualifying relative must (1) be related to the taxpayer (or reside in the taxpayer's home for the entire year), (2) have gross income less than the personal exemption amount, and (3) receive over one-half of his or her support from the taxpayer.

Both types of dependents also must meet several requirements: (1) have a social security number reported on the taxpayer's return, (2) meet a citizenship test, (3) cannot normally file a joint return, and (4) cannot claim others as dependents. pp. I:2-12 through I:2-17.

I:2-5 a. Support includes amounts spent for food, clothing, shelter, medical and dental care, education, and the like. Support does not include the value of services rendered by the taxpayer for the dependent nor does it include a scholarship received by a son or daughter of the taxpayer.

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b. Yes. When several individuals contribute to the support of another, it is possible for members of the group to sign a multiple support agreement that enables one member of the group to claim the dependency exemption. Also, in the case of divorced couples, the parent with custody for over half of the year receives the dependency exemption even if that parent did not provide more than 50% of the child's support. Similarly, in the case of a written agreement, the dependency exemption can be given to the noncustodial parent even if that parent provided 50% or less of the child's support.

c. The value of an automobile given to an individual may represent support for that individual. The automobile must be given to the individual and must be used exclusively by the individual. pp. I:2-15 through I:2-18.

I:2-6 A taxpayer will use a rate schedule instead of a tax table if taxable income exceeds the maximum in the tax table (currently $100,000) or if the taxpayer is using a special tax computation method such as short-year computation. p. I:2-20.

I:2-7 a. In general, it is the taxpayer's gross income that determines whether the individual must file a return. The specific dollar amounts are listed in the text. Certain individuals must file even if they have less than the specified gross income amounts. These include taxpayers who receive advance payments of the earned income credit and taxpayers with $400 or more of self-employment income. Dependent individuals must file if they have either (1) unearned income over $1,050 or (2) total gross income in excess of the standard deduction.

b. Taxpayers who owe no tax because of deductions or other reasons must still file a return if they have gross income in excess of the filing requirement amounts. p. I:2-35.

I:2-8 Home mortgage interest and real property taxes are itemized deductions. As a result those expenses alone often exceed the standard deduction, enabling a homeowner to itemize. Renters typically do not have these deductions, so the standard deduction may be greater than itemized deductions. p. I:2-11.

I:2-9 If the threshold were "50% or more" two individuals who provided equal amounts of support for another person could both claim a dependency exemption for that individual. By specifying "over 50%" only one individual can meet the requirement. A multiple support agreement could be used by two individuals who provide equal amounts of support to allow one of the two to claim a dependency exemption. p. I:2-15.

I:2-10 The normal due date for calendar-year individuals and C corporations is April 15. The normal due date for calendar-year partnerships and S corporations is March 15. If the normal due date is a Saturday, Sunday, or holiday, the normal due date is delayed to the next day that is not a Saturday, Sunday or holiday. p. I:2-35.

I:2-11 Automatic extensions of six months generally are available. For a C corporation, the extension is five, six, or seven months, depending on fiscal year-end. Any tax that may be owed must be paid with the application for an extension. p. I:2-36.

I:2-12 Yes. In general, the source of income is not important. It is the use that is important. An exception does exist for a child's scholarship. Parents do not have to consider a child's scholarship when determining whether they provide over half of the child's support. p. I:2-15.

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I:2-13 It can be, but as was noted in the preceding answer, parents may ignore a child's scholarship in deciding whether they provide over half of the child's support.

I:2-14 The purpose of the multiple support agreement is to allow one member of a group to claim a dependency exemption when the members together contribute more than 50% of the support of another person and each member of the group contributes over 10%. The multiple support agreement results in an exception to the requirement that the taxpayer alone must provide over one-half of the dependent's support. p. I:2-17.

I:2-15 In general, the parent with custody for the greater part of the year receives the exemption. The noncustodial parent is entitled to the dependency exemption only if required documentation provides that the noncustodial parent is to receive the exemption. p. I:2-17.

I:2-16 In general, a couple must be married on the last day of the tax year in order to file a joint return. In addition, the spouses must have the same tax year. Also, if one spouse is a nonresident alien, then that spouse must agree to include all of his or her gross income on the return. p. I:2-21.

I:2-17 The phrase "maintain a household" means to pay over one-half of the costs of the household. These costs include property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance and food consumed on the premises. Such costs do not include clothing, education, medical treatment, vacations, life insurance and transportation. p. I:2-23.

I:2-18 A married person, if otherwise qualified, can claim head-of-household status if he or she is married to a nonresident alien or if he or she qualifies as an abandoned spouse. To be an abandoned spouse, the taxpayer must have lived apart from his or her spouse for the last six months of the year and maintain a household for a qualifying child in which they both live. pp. I:2-22 and I:2-23.

I:2-19 a. A C Corporation is taxed on its income. In other words, it is taxed as a separate entity. An S Corporation is normally not taxed on its income. Instead, its income flows through and is reported by the shareholders. Each shareholder reports his or her share of the income even if it is not actually distributed.

b. Some corporations are ineligible for making an S corporation election. Others may choose the C corporation because of lower corporate tax rates on taxable income up to $75,000. Other considerations not discussed in Chapter 2 include fringe benefits, the need to retain earnings in the business and dividend policy. pp. I:2-27 and I:2-28.

I:2-20 Up to $50,000 of income earned by a C corporation is taxed at 15%. If an individual with a significant amount of other income operates a new business as a proprietorship, that income is taxed at the owner's marginal tax rate, which will be higher than 15%. Thus, the current tax can be reduced if the corporate form is used and income is retained in the corporation. This advantage is lost if the corporation distributes the income. New businesses often need to retain income for expansion. p. I:2-27.

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I:2-21 a. The major categories of property excluded from capital asset status are:

- Inventory
- Trade receivables
- Certain properties created by the efforts of the taxpayer
- Depreciable business property and business land
- Certain government publications.

b. Yes. A net long-term capital gain generally is taxed at 15% (0% in the case of an individual taxpayer who is in the 10% or 15% tax bracket and 20% in the case of an individual in the 39.6% tax bracket). Short-term capital gains are taxed much like other income.

c. The availability of favorable tax rates for long-term gains is one implication of capital asset classification. Another is the limitation on the amount of capital loss that can be deducted from other income. At the present time, only $3,000 of net capital loss can be deducted from other income by an individual taxpayer in any year. p. I:2-30.

d. Individual taxpayers first deduct (or offset) capital losses from capital gains. If a net capital loss results, only $3,000 of the net capital loss can be deducted from other income. Net capital losses in excess of $3,000 are carried over to future years. p. I:2-30.

I:2-22 Yes. By waiting the taxpayer can convert the short-term gain to a long-term gain taxed at a maximum rate of 20%. The long-term rate will be available if the taxpayer holds the property over 12 months. The taxpayer should, however, take into consideration other nontax factors such as whether the value of the asset may decline during the extended holding period. p. I:2-30.

I:2-23 a. Shifting income means moving income from one tax return to another. Splitting income means creating additional taxable entities (such as corporations) so as to spread income between more taxpayers.

b. Different taxpayers are in different tax brackets. As a result, taxes can be saved by shifting income from a taxpayer who is in a high tax bracket to a taxpayer who is in a lower tax bracket.

c. The tax on the unearned income of a minor (i.e., the kiddie tax) was created to reduce the opportunity to reduce taxes by shifting income from parents who are in high tax brackets to children who have little or no other income and would, therefore, normally be in a low tax bracket. pp. I:2-32 and I:2-33.

I:2-24 a. Both spouses are liable for additional taxes on a joint return. An exception exists for a so-called innocent spouse. To utilize the innocent spouse provision, the tax must be attributable to erroneous items of the other spouse. In addition, the innocent spouse cannot have known or had reason to know of the error, and must elect relief within two years after the IRS begins collection activities. Further, it must be inequitable to hold the innocent spouse liable for the understatement.

b. In the event of underpayment of taxes on a joint return, the IRS can collect the unpaid tax from either spouse. pp. I:2-33 and I:2-34.

I:2-25 Couples may change from joint returns to separate returns only prior to the due date for the return. Couples may change from separate returns to a joint return within three years of the due date including extensions. pp. I:2-33 and I:2-34.

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Issue Identification Questions

I:2-26 The main issue is whether Yung can claim a dependency exemption for his nephew. The nephew must be a U.S. resident in order to qualify. Normally, this requires that a person have a visa as a permanent resident, but a dependency exemption has been permitted when special circumstances were present. For example, the Tax Court allowed an exemption when it considered the length of the dependent's stay, the individual's intent, and the presence of substantial assets in the U.S. [Carmen R. Escobar, 68 TC 304 (1977)]. The nephew's desire to stay and the desire of other members of the family to move here could all be factors that are considered in determining whether the nephew is a resident. p. I:2-13.

I:2-27 The primary tax issue is whether they should file a joint return. Filing jointly could produce a tax savings because more income will be taxed at the low 10% and 15% rates. Carmen, however, should carefully consider whether Carlos is disclosing all of his income. If not, she may be liable for additional taxes, interest, and penalties resulting from the unreported income. The innocent spouse rules may not protect her. She is not required to know with certainty Carlos' income in order to be liable. The fact that Carmen is "surprised" that Carlos' income is so low suggests that she has reason to know that there is unreported income. p. I:2-33.

I:2-28 The primary tax issue is the filing status for both Bill and Jane. Both can file as single taxpayers because they were divorced prior to the end of the tax year. To file as a head of household a taxpayer must pay more than one-half of the costs of maintaining a household (as one's home) in which a dependent relative lives for more than one-half of the year. In the case of divorce, the child need not be a dependent of the custodial spouse. The facts in this question are similar to W.E. Grace v. CIR, 25 AFTR 2d 70-328, 70-1 USTC ¶ 9149 (5th Cir., 1970) and Levon P. Biolchin v. CIR, 26 AFTR 2d 70-5727, 70-2 USTC ¶ 9674 (7th Cir., 1970) where the courts disregarded the fact that the taxpayer owned the house and denied head of household status. Jane should also fail to qualify for head of household status because she did not pay more than one-half of the costs of maintaining the household. Secondary issues concern the treatment of child support payments and whether the furnishing of home expenses can be treated as alimony. pp. I:2-22 and I:2-23.

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Problems

I:2-29

	Lanes	Waynes
Salary	$32,000	$115,000
Taxable interest income	1,000	10,000
Gross Income	$33,000	$125,000
Minus: IRA Contribution	(5,500)	-0-
Adjusted gross income	$27,500	$125,000
Minus: Itemized deductions	(15,000)	(15,000)
Exemptions	(8,100)	(8,100)
Taxable Income	$ 4,400	$101,900
Gross tax (using Rate Schedule)	$ 440*	$ 16,953*
Minus: Withholding	(700)	(18,700)
Tax due (refund)	($ 260)	($ 1,747)

* This answer is based on the 2017 rate schedule. The 2017 tax table was unavailable at the time this solution was prepared. The actual answer using the tax table would be very close to the above answer. pp. I:2-6 and I:2-7.

I:2-30 a.

Salary	$ 1,800
Taxable interest income	1,600
Adjusted gross income	$ 3,400
Minus: Standard deduction	(6,350)
Exemption	(4,050)
Taxable income	-0-

b.

Salary	$ 1,800
Taxable interest income	1,600
Adjusted gross income	$ 3,400
Minus: Standard deduction ($1,800 + $350)	(2,150)
Exemption	-0-
Taxable income	$ 1,250

pp. I:2-11 and I:2-12.

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I:2-31	a.	Adjusted gross income ($14,000 + $22,000)	$36,000
		Minus: Standard deduction	(12,700)
		Exemptions	(8,100)
		Taxable income	$15,200
	b.	Adjusted gross income (Carl)	$14,000
		Minus: Itemized deductions	-0-
		Exemption	(4,050)
		Taxable income	$9,950
		Adjusted gross income (Carol)	$22,000
		Minus: Itemized deductions	(8,500)
		Exemption	(4,050)
		Taxable income	$ 9,450

Note: Because Carol claimed itemized deductions on her return, Carl must also itemize. Both could have claimed a standard deduction of $6,350 (total of $12,700), so combined they lost deductions of $4,200 ($12,700–$8,500) by itemizing.

p. I:2-32.

I:2-32	a.	Adjusted gross income ($20,000 + $800)	$20,800
		Minus: Standard deduction	(12,700)
		Exemptions (2 x $4,050)	(8,100)
		Taxable income	$ 0
		Gross tax	$ 0
	b.	Adjusted gross income	$20,000
		Minus: Standard deduction	(6,350)
		Exemption	(4,050)
		Taxable income	$ 9,600
		Gross tax	$ 974

c. Julio and Jillian should not file a joint return. The parents will have to pay an additional $1,134 in taxes, while Julio and Jillian only save $974 ($974 - $0) by filing a joint return.

I:2-33 a. Brian may not be claimed as a dependent because his gross income exceeds $4,050 (2017). Brian is not a qualifying child because he is over age 23. He is not an other dependent because he fails the gross income test.

b. No effect. Brian's student status is irrelevant because he is over age 23. Thus, Wes and Tina may not claim Brian in this case.

c. Sherry may be claimed as a dependent by Wes and Tina as she is considered a qualifying child. She meets the four tests of relationship, age, abode, and support. Her gross income is not relevant.

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d. Under these facts, Sherry would not be eligible to be claimed as a dependent because she isn't a qualifying child. Under the other dependent test, the gross income test may not be waived, as she is not a full-time student and is over age 18.

e. Granny may not be claimed as a dependent as she fails the gross income test. Her interest from the U.S. bonds exceeds $4,050 and no exception applies. If Granny's interest had been less than $4,050, she would have qualified, as Social Security is not included in her gross income.

pp. I:2-14 through I:2-18.

I:2-34 a. Carole and John can claim David and Kristen this year. Jack is not a qualifying child (over age 18 and not a full-time student) and is not another relative because his gross income exceeds $4,050. David can be claimed as a dependent because he is considered a qualifying child. He meets the four tests of relationship, age, abode, and support. Gross income is not considered for the qualifying child test. Kristen also is a qualifying child and can be claimed as a dependent.

b. Assuming Jack is a full-time student in medical school for at least five months this year, he would be considered a qualifying child as he now meets the age test (under age 24 and a full-time student). Carole and John can claim Jack as a dependent.

c. In this case, Jack would not be a qualifying child because he fails the age test. However, he is a qualifying relative as he meets the relationship, gross income, and support tests. His gross income is less than $4,050 in 2017.

d. If David were a part-time student, he would not be either a qualifying child or qualifying relative. With respect to the qualifying child test, David fails the age test as he is a part-time student. As to the qualifying relative test, David fails the gross income test.

e. David would not be a dependent as he fails the support test for both the qualifying child and qualifying relative tests. pp. I:2-14 through I:2-18.

I:2-35 a. Robert cannot claim Jane as a dependent. Jane is not his qualifying child as she fails the age, abode, and presumably the support test. The facts in the problem do not specify how the $26,000 ($11,000 + $15,000) of support is allocated between Jane and her two children. But this is irrelevant as she fails the age and abode tests. Jane also fails the qualifying relative test because she has too much gross income.

b. Jane can claim her children as dependents. Robert apparently provides over one-half of their support, but that is irrelevant as they are Jane's "qualifying children." The support requirement only says that the children cannot be self-supporting.

c. Jane is entitled to the child credit for each of her two children. Even if Robert were eligible to claim dependency exemptions for the children, he would not benefit from the child credit because of his income. pp. I:2-14 through I:2-18.

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I:2-36 Based on the facts given, Juan cannot claim either Maria or Norma as dependents. He can claim Jose only if written documentation exists.

Maria cannot be claimed as a dependent as she provides over one-half of her own support.

Although Juan provides more than one-half of Jose's support, Jose lives with Linda. Absent required documentation, Linda is entitled to the dependency exemption. If Linda signs a completed Form 8332, Juan can claim the exemption.

Norma is not a "qualifying child" for either her father or Jose as she lives with neither. Further, she is a part-time student. She does not qualify as a "qualifying relative" because she has too much gross income. pp. I:2-14 through I:2-18.

I:2-37 a. Either Mario or Elaine. Caroline cannot because she is unrelated to Anna, and Doug cannot because he provides less than 10% of Anna's support.

b. Elaine must agree in writing to the arrangement.

c. No. Head-of-household status cannot be based on a dependency exemption obtained as the result of a multiple support agreement.

d. No. Old-age allowances are not available for dependents. Old-age allowances increase the amount of the standard deduction. pp. I:2-14 through I:2-18.

I:2-38 a. Joan, the custodial spouse, receives both the dependency exemption and child credit.

b. No. p. I:2-17.

I:2-39

	Form	Filing Status	Exemptions	Child Credit
a.	1040EZ	Single	1	0
b.	1040A	Single	1	0
c.	1040	Head-of-Household	1	0
d.	1040A	Single	1	0
e.	1040A	Head-of-Household	2	1

In part a, Arnie could file a Form 1040 or Form 1040A instead of a Form 1040EZ, but he is not required to do so. In parts b, d, and e, the taxpayer could file a Form 1040 instead of a Form 1040A but is not required to do so. pp. I:2-14 through I:2-24.

I:2-40 a. No dependency exemption or child credit. A cousin must live with the taxpayer in order to qualify as a dependent as a cousin does not automatically meet the relationship test.

b. One dependency exemption. Because the social security benefits are excluded from gross income, the father meets the gross income test. The father is not required to live with Bob to meet the relationship test.

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c. One dependency exemption, no child credit. The daughter is considered a qualifying child and, because she is a full-time student under age 24, the gross income test is not relevant. Because she is over 16, she does not qualify for the child credit.

d. No dependency exemption or child credit. The mother cannot be claimed as a dependent by anyone because she provided over half of her own support. pp. I:2-14 through I:2-20.

I:2-41 a. The information provided suggests that Juan will be in a higher tax bracket than Maria. As a result, personal exemptions are worth more to Juan than to Maria.

b. The child credit is phased out for single taxpayers with AGI above $75,000. Because of his high income, Juan will not be entitled to any child credit. Accordingly, it is their combined tax advantage to allow Maria to take the child credit. The credit, however, is only available to taxpayers who claim dependency exemptions for children. Juan would not willingly agree to forego the dependency exemption without some consideration. The tax savings received by Maria from the dependency exemptions and the child credit should be considered when the amount of child support is being determined.

c. As the custodial parent, Maria is entitled to file as a head-of-household. This is true even if she does not claim the dependency exemption or child credit. Juan will file as a single taxpayer. pp. I:2-18 and I:2-19.

I:2-42 a.

Adjusted gross income ($32,000 + $39,000)	$71,000
Minus: Itemized deductions ($12,000 + $1,600)	(13,600)
Personal exemptions (2 x $4,050)	(8,100)
Taxable income	$49,300
Gross tax	$ 6,463*

b. Mary's tax filing as a single taxpayer:

Adjusted gross income	$39,000
Minus: Standard deduction	(6,350)
Personal exemption	(4,050)
Taxable income	$28,600
Gross tax	$ 3,824*

Bill's tax filing as a single taxpayer:

Adjusted gross income	$32,000
Minus: Itemized deductions	(12,000)
Personal exemption	(4,050)
Taxable income	$15,950
Gross tax	$ 1,926*

Their income taxes total $5,750 ($3,824 + $1,926).

*These amounts are based upon the 2017 tax rate schedule because the 2017 tax table was unavailable when the solution was prepared.

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c. Their tax will be $713 ($6,463- $5,750) higher if they marry before year-end. This is attributable to the fact that the itemized deduction available to Bill and the standard deduction available to Mary if they are unmarried are greater than the itemized deductions available to them if they are married—$713 [0.15 x ($6,350 + $12,000 - $13,600)]. pp. I:2-20 through I:2-23.

I:2-43 a. Amy need not file because her gross income is less than the threshold of $10,400 and her self-employment income is less than $400.

b. Betty need not file, as her gross income ($9,100) is less than $11,950 ($6,350 + $1,550 + $4,050).

c. Chris must file, as his gross income of $2,300 exceeds his standard deduction $2,250 ($1,900 + $350). Chris' standard deduction is limited to the amount of earned income plus $350.

d. Dawn must file because her unearned income is over $1,050 and her total gross income exceeds her standard deduction.

e. Doug must file because his gross income is over $4,050 and he is married and not living with his spouse. p. I:2-35.

I:2-44 a. Yes.

b. No. The aunt would have to live with the taxpayer.

c. No. Because she qualifies for the more favorable surviving spouse status, she cannot file as head-of-household.

d. Yes. Because he qualifies as an abandoned spouse he can file as a head-of-household. pp. I:2-20 through I:2-24.

I:2-45 a. 2015: Celia files a joint return even though Wayne died in October.

2016: Celia must file as a single taxpayer. As a part-time student, Wally is not a qualifying child.

2017: Same as 2016.

2018: Same as 2016.

b. Single. Juanita does not qualify for head-of-household status because Josh is not a "qualifying child." He is over 18 and is not a full-time student.

c. Gertrude may use the head-of-household filing status. Even though she is still legally married, she meets the tests for an abandoned spouse. She lived apart from her spouse for the last six months of the taxable year and paid over one-half the cost of maintaining a household for her dependent son. pp. I:2-21 through I:2-23.

Note to Instructor: A good exercise is to ask the class how the solution for part a would change if Wally were a full-time student rather than part-time. Celia would qualify as a surviving spouse in 2016 and 2017 and a single taxpayer in 2018.

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I:2-46 a. $95,000 ($46,000 + $49,000).

b.

Gross income	95,000
Minus: Business expenses	(24,000)
IRA contributions	(11,000)
Adjusted gross income	$60,000

c.

Adjusted gross income	$60,000
Minus: Itemized deductions	(13,000)
Exemptions ($4,050 x 3)	(12,150)
Taxable income	$34,850

pp. I:2-6 and I:2-7.

I:2-47 Jan should take the standard deduction. Jan cannot deduct any medical expenses or miscellaneous expenses as they are less than the applicable floors (10% AGI floor for medical and 2% of AGI floor for miscellaneous deductions). She is left with $5,000 of itemized deductions (mortgage interest of $3,000 and property taxes of $2,000) which are less than the $6,350 standard deduction. p. I:2-10.

I:2-48 $1,850 (salary $4,200 + interest $2,200 - standard deduction ($4,200 + $350)). The taxable income would be the same if she were 16 years of age. However, the tax rate applicable to $100 ($2,200 - $2,100) of the interest income would depend on the parents' tax bracket and not be based on Debbie's income (If she is 23 years old and a full-time student, the parents' tax bracket will be used if her earned income is less than half of her support). pp. I:2-24 through I:2-26.

I:2-49 a. Adjusted gross income:

Salary	$130,000
Allowable capital loss	(3,000)
Adjusted gross income	$127,000

b. Itemized deductions:

Home mortgage interest	$ 10,000
State income taxes	4,000
Charitable contributions	5,000
Itemized deductions	$ 19,000

c. Personal exemptions ($4,050 x 4) $ 16,200

d. Taxable income:

Adjusted gross income	$127,000
Itemized deductions	(19,000)
Personal exemptions	(16,200)
Taxable income	$ 91,800

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I:2-50

Karen
Karen's gross tax is $371. At age 21, Karen is subject to the kiddie tax because she is a full-time student who earned less than one-half of her own support and who has unearned income in excess of $2,100.

Taxable income:	
Wages	$3,000
Interest	2,800
Adjusted gross income	$5,800
Standard deduction ($3,000 + $350)	(3,350)
Taxable income	$2,450
Net unearned income:	
Unearned income	$2,800
Statutory deduction	(1,050)
Portion of standard deduction	(1,050)
Net unearned income	$ 700
Gross tax:	
Tax on net unearned income ($700 X 0.28)	$ 196
Tax on taxable income less net unearned income ($1,750 X 10%)	175
Gross tax	$ 371

Mike and Linda's taxable income of $180,000 is in the 28% tax bracket (see the tax rate schedule for married couples filing jointly). Karen's net unearned income thus is taxed at a 28% rate.

Susan
Susan's gross tax is $705. Susan does not owe the kiddie tax as she is age 18 and her earned income is greater than one-half of her support.

Wages	$11,000
Interest	2,400
Adjusted gross income	$13,400
Standard deduction	(6,350)
Taxable income	$7,050
Gross tax	$ 705

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Amelie
Amelie's gross tax is $203. Amelie is subject to the kiddie tax as she is under age 18 and her unearned income is greater than $2,100.

Taxable income:	
Wages	$5,900
Interest	2,200
Adjusted gross income	$8,100
Standard deduction ($5,900 + $350)	(6,250)
Taxable income	$1,850
Net unearned income:	
Unearned income	$2,200
Statutory deduction	(1,050)
Portion of standard deduction	(1,050)
Net unearned income	$ 100
Gross tax:	
Tax on net unearned income ($100 X 0.28)	$ 28
Tax on taxable income less net unearned income ($1,750 X 0.10)	175
Gross tax	$ 203

I:2-51 a.

Salary	$ 60,000
S corporation income	40,000
Adjusted gross income	$100,000
Itemized deductions	(18,000)
Personal exemption	(4,050)
Taxable income	$ 77,950
Gross tax	$ 15,226

b.

Corporation:	
Taxable income	$ 40,000
Gross tax (0.15 x $40,000)	$ 6,000
Individual:	
Salary	$ 60,000
Dividend ($40,000 - $6,000)	34,000
Adjusted gross income	$ 94,000
Itemized deductions	(18,000)
Personal exemption	(4,050)
Taxable income	$ 71,950
Gross tax	$ 10,326*
Total tax ($6,000 + $10,326)	$ 16,326

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*The individual's gross tax is the total of the tax on the dividend income and the tax on the remaining income. The tax on the dividend income of $34,000 is $5,100 (0.15 x $34,000). The tax on the remaining income of $37,950 ($71,950 - $34,000) is $5,226 computed using the rate schedule for single taxpayers.

c. The answer to part a is unchanged as the shareholder is taxed on the S corporation's income regardless of whether it is distributed. In part b, the corporation's tax is the same, $6,000, but the shareholder is only taxed on the salary of $60,000.

Adjusted gross income	$ 60,000
Itemized deductions	(18,000)
Personal exemption	(4,050)
Taxable income	$ 37,950
Gross tax	$ 5,226
Total tax ($6,000 + $5,226)	$ 11,226

The shareholder will be taxed on the corporation's undistributed income if it is paid out as a dividend in a future year.

pp. I:2-27 through I:2-30.

I:2-52 Lana's child credit is $2,450 [(3 x $1,000) - ($50 x 11)]. p. I:2-19.

I:2-53 a. They will save $1,188 ($3,000 x 0.396). Only $3,000 of loss can be offset against other income. The remaining $12,000 of loss can be carried over and offset against future income.

b. The additional tax is $2,000 ($10,000 x 0.20).

c. They will save $1,188 as in part a. The net loss is $5,000 but as in part a, only $3,000 can be offset against other income. The carryover, however, is only $2,000 ($15,000 - $10,000 - $3,000). p. I:2-30.

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I:2-54

		2017	2018
a.	Salary	$20,000	$20,000
	Minus: Itemized or standard deduction	(6,350)	(9,000)
	Exemption	(4,050)	(4,050)
	Taxable income	$ 9,600	$ 6,950
	Gross Tax	$ 974	$ 695
b.	Salary	$20,000	$20,000
	Minus: Itemized or standard deduction	(6,350)	(8,000)
	Exemption	(4,050)	(4,050)
	Taxable income	$ 9,600	$ 7,950
	Gross tax	$ 974	$ 795
c.	Salary	$20,000	$20,000
	Minus: Itemized or standard deduction	(6,350)	(10,000)
	Exemption	(4,050)	(4,050)
	Taxable income	$ 9,600	$ 5,950
	Gross tax	$ 974	$ 595

d. By contributing the $2,000 in 2018, Virginia is able to deduct the entire amount. If $1,000 is contributed in each year, only the $1,000 contributed in 2018 is deductible. No tax benefit is received in 2017 because the contribution is less than the standard deduction. If $2,000 is contributed in 2017, then no tax benefit is received. pp. I:2-32 and I:2-33.

I:2-55 a. 1040A
b. 1040
c. 1040A
d. 1040A

In parts a, c, and d, the taxpayer could file a Form 1040 instead of a Form 1040A but is not required to do so. p. I:2-36.

I:2-56 a. Maria's adjusted gross income is $48,000.

Salary	$51,000
Capital loss allowable	(3,000)
Adjusted gross income	$48,000

b. Maria's taxable income is $37,600.

Adjusted gross income	$48,000
Standard deduction	(6,350)
Personal exemption	(4,050)
Taxable income	$37,600

c. Maria's tax liability is $5,174.

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I:2-57 a. As no special rules apply and taxable income is $83,000, the gross tax is $12,228.

b. Ralph and Tina are entitled to a child credit for Tina equal to $1,000.

c. Pam's gross tax is computed as follows:

Adjusted gross income (interest)	$3,500
Minus: Standard deduction	(1,050)
Taxable income	$2,450
Tax on first $1,050 (0.10 x $1,050)	$ 105
Tax on remaining $1,400 (0.25 x $1,400)	350
Gross tax	$ 455

d. If Pam were age 25, her tax would be computed without reference to the parents' tax rate. Thus, her tax would be $245 (0.10 x $2,450) assuming she is still a dependent.

I-2:58 a. Gail qualifies as a surviving spouse. She is eligible to use the joint return rate schedule.

b. Her taxable income and gross income tax are computed as follows:

Adjusted gross income	$382,400
Minus: Itemized deductions	(17,942)*
Personal and dependency exemptions	(3,564)**
Taxable income	$360,894
Gross income tax	$ 94,312

*$20,000 - [0.03 x ($382,400 - $313,800)]
**($382,400 - $313,800)/$2,500 = 27.44, which rounds up to 28
28 x 0.02 = 0.56
($4,050 x 2) – (0.56 x $4,050 x 2) = $3,564

Because of her high income, Gail's child credit is fully phased-out and she also owes a 3.8% tax on her investment income over $250,000 or $5,031 (0.038 x [$382,400 - $250,000]).

c. Because having a dependent child is required to qualify as a surviving spouse, Gail must file as a single taxpayer.

pp. I:2-10, I:2-18, and I:2-31.

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Tax Strategy Problems

I:2-59 The tax liability under the three alternatives is computed as below:

Business income	**Proprietorship**	**S Corporation**	**C Corporation**
Operating income	$ 60,000	$60,000	$60,000
Compensation paid to Jack		(40,000)	(40,000)
Net	$ 60,000	$20,000	$20,000
Corporate income tax			$ 3,000
Jack's income			
Business income	$ 60,000	$20,000	
Compensation		40,000	$40,000
Dividends			5,000
Other income	1,000	1,000	1,000
Adjusted Gross Income	$ 61,000	$61,000	$46,000
Other itemized deductions	(10,000)	(10,000)	(10,000)
Personal exemption	(4,050)	(4,050)	(4,050)
Taxable income	$ 46,950	$46,950	$31,950
Individual income tax	$ 7,476	$ 7,476	$ 3,576
Total tax	$ 7,476	$ 7,476	$ 6,576

The total tax paid when Jack operates the business as a C corporation is less than the tax paid with the other organizational forms. He, however, does face a potential future individual income tax on the remaining $12,000 ($20,000 - $3,000 - $5,000) of corporate income in the year he distributes that income. The reason the tax is less now is because higher rates apply to the additional income reported on his personal return when he operates as a proprietor or when he makes an S election. Dividends received by individuals in the 10% and 15% tax brackets are exempt from income tax. Jack's taxable income is $31,950 which is below the top-end of the 15% tax bracket. As a result, the current year's dividends do not result in a tax. Nevertheless, there may be a tax on future dividend distributions if Jack has more income. pp. I:2-27 through I:2-30.

I:2-60 a. Andrea will save $792 (39.6% x $2,000) if she makes the contribution.

b. Andrea's taxes will not change because the contribution is not deductible.

c. Andrea will save $238 (39.6% x $600) if she makes the gift. Given the amount of her income, the daughter will owe no tax.

d. Andrea will save $238. She however will not be as well off because the exempt interest of $300 is less than the after tax interest of $362 ($600 - $238) from the taxable bonds.

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Tax Form/Return Preparation Problems

I:2-61 (See Instructor's Resource Manual)

I:2-62 (See Instructor's Resource Manual)

I:2-63 (See Instructor's Resource Manual)

Case Study Problems

I:2-64 This question has some interesting implications. One problem relates to the sale of the loss property. Bala and Ann can only deduct $3,000 of the capital loss from ordinary income each year. As a result, it would take ten years to use up the loss unless they realize a capital gain against which to offset the loss. Although a $3,000 capital loss offsets income that would otherwise be taxed at 39.6%, it takes a long time to use up the loss. If Bala and Ann sell both of the parcels they own they will realize a net loss of $8,000, which will be used up in the current and next two years even if they realize no additional gains. Further, the $8,000 net loss will offset income that would otherwise be taxed at 39.6%.

Because of her age, Kim is currently subject to the "kiddie tax", which means that most of her capital gain will be taxed at her parents' rate (20% for capital gains). By waiting to sell her land when she is no longer subject to the kiddie tax, she will be able to use her standard deduction to offset part of the gain and the remainder may be taxed at a low rate (perhaps zero). p. I:2-30.

I:2-65 As Larry and Sue were married at the end of the year, they can file either a joint income tax return or two separate returns. On the surface there is not much difference between the tax liability on a joint return versus separate returns. The important issue here is the fact that Sue believes that Larry may be under-reporting tip income. If they file a joint return, Sue may be liable for the joint tax liability including penalties that may result from under-reporting. There is an innocent spouse provision, but one condition for claiming innocent spouse status is that the taxpayer did not know and had no reason to know that there was under-reporting. As Sue is suspicious of her husband, she should file a separate return to protect herself from possible tax liability associated with unreported income. pp. I:2-33 and I:2-34.

Tax Research Problems

I:2-66 Since the stepdaughter and her family do not live with Ed, they must be related to him in order to qualify as his dependents. Clearly, the stepdaughter meets this test. Stepdaughters are specifically listed in Sec. 152(a)(2) as relatives. Further, Reg. Sec. 1.152-2(d) states that a relationship "once existing will not terminate by divorce or death of a spouse."

On the other hand, Ed is not related to the stepdaughter's husband. Stepson-in-laws are not listed in Sec. 152(a). The Tax Court in Desio Barbetti [9 T.C. 1097 (1947)] held that the term "grandchildren" does not include step-grandchildren, and that neither stepchild nor son-in-law covers stepson-in-laws. Current law refers to step-children and their descendants which suggests that the child is eligible to be claimed as a dependent.

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I:2-67 The full exemption deduction for a dependent is available even though the dependent is born or dies during the year. In Rev. Rul. 73-156, 1973-1 C.B. 58, the IRS ruled that an exemption may be claimed if state or local law treats the child as having been born alive, and this is evidenced by an official document such as a birth or death certificate. If the child had no social security number the IRS instructs taxpayers to enter "Died" in place of the social security number on Form 1040.

I:2-68 Although Larry may not meet the technical definition of "blind" when he wears the new contact lens, the fact that he can only wear the lens for brief times means that he cannot depend on having the advantage of improved sight. Therefore, the Tax Court in Emanuel Hollman, 38 T.C. 251 (1963) granted an extra personal exemption for blindness permitted under prior law. It seems likely that the same rule would be available to taxpayers today claiming the additional standard deduction amount available to blind taxpayers under current law.

"What Would You Do In This Situation?" Solution

Ch. I:2, p. I:2-28.

A married person has the option of filing a joint return or as a married person filing separately. Whether a person is married depends on the laws of the state of residence. The abandoned spouse rules provide an exception, but the rules only apply if the taxpayer maintains a household for a dependent child. This case does not indicate that Jane has a child.

State laws establish conditions that must be met for a missing person to be declared legally dead. Typically, a missing person cannot be declared legally dead for seven years. During the interim, a guardian can be appointed to handle the affairs of the missing person. This all taken together indicates that Jane is still classified as a married person for tax purposes.

The IRS has ruled that a spouse who is appointed guardian may elect to file a joint return with his or her missing spouse (Rev. Rul. 55-387, 1955-1 CB 131). The joint return would enable Jane to take advantage of the lower rate schedule, claim an additional personal exemption, and utilize a larger standard deduction. Before she could file a joint return, Jane would have to be appointed as Jim's guardian.

Choosing to file a joint return does have some risks. Jane does not know how much income Jim has or whether he is even alive. Should she file a joint return, the innocent spouse provision probably would protect Jane from tax on any income that Jim may be earning.

One unusual aspect of the situation is that the IRS may know of her husband's status. This is because the IRS would have any return that Jim is filing and have information on any income that is being reported under his social security number on 1099's and W-2's. The IRS is prohibited from giving out information on taxpayers including where they live. As a result, it is unclear what the IRS would do with the information should Jane file a joint return.

Jane could file for a divorce. If the divorce were granted before year end, Jane would file as a single taxpayer. Also, if Jim is declared legally dead Jane will file as a single taxpayer.

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Chapter I:2

Determination of Tax

Learning Objectives

After studying this chapter, the student should be able to:

1. Use the tax formula to compute an individual's taxable income.
2. Determine the amount of deductions from Adjusted Gross Income.
3. Calculate the income tax for individuals.
4. Explain the basic income tax rules relating to business entities.
5. Explain the basic income tax rules of capital gains and losses.
6. Compute the income tax for high-income individuals.
7. Describe tax planning considerations for various tax matters.
8. Describe compliance and procedural matters for filing tax returns.

Areas of Greater Significance

It is absolutely vital that students understand the individual formula for calculating the tax or refund due (including standard deduction, exemptions, and filing status). This formula is necessary throughout the balance of the text to work out the problems. Any deficiencies in understanding at this point would be carried over to subsequent materials.

Areas of Lesser Significance

In the interest of time, the instructor may determine that the following area is best covered by student reading, rather than class discussion:

1. Business income and business entities.

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Problem Areas for Students

The following areas may prove especially difficult for students:

1. Whether a taxpayer qualifies for head of household filing status.

2. The relationship between the standard deduction and itemized deductions.

3. Whether the qualification (or non-qualification) of a person for dependency exemption affects the head of household filing status (i.e., the rules for head of household and dependency exemptions overlap, but are not totally consistent).

Highlights of Recent Tax Law Changes

The following items of tax law have changed since the 2017 edition of this chapter:

1. The AGI floor for medical expenses is now 10% for all taxpayers regardless of age.

2. The standard deduction amount for each filing status has increased for 2017. (See page I:2-10.)

3. The income limits for all tax brackets and for each filing status have increased. (See inside front cover.)

4. The floor for filing a tax return for each filing status, except for married filing separately has increased. (See page I:2-35.)

5. The minimum extension for C corporations upon filing Form 7004 is now six months.

Teaching Tips

1. Due to the annual changes in many of the rules covered in this chapter (i.e., standard deduction, exemption amount) you may wish to inform the students that examinations and/or quizzes will be held on an open-book basis or that you will provide any required statutory amounts for testing purposes. Using this approach allows the students to concentrate on the concepts rather than memorizing numbers.

2. This introductory chapter is a good place to begin emphasizing the difference between deductions for AGI and deductions from AGI. This distinction will increase in importance in subsequent chapters.

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Lecture Outline

I. Formula for Individual Income Tax

1. Basic Formula (Table I:2-1, Example I:2-1; Question I:2-1; Problem I:2-29; Figure I:2-1)

    a. The basic formula for calculating individual income tax is:

        i. Gross income - Exclusions = Adjusted gross income

        ii. Adjusted gross income - (Deductions + Exemptions) = Taxable income

        iii. Taxable income × Tax rate(s) = Gross tax

        iv. Gross tax (Credits + Prepayments) = Net tax

2. Definitions (Tables I:2-2, I:2-3, I:2-4, I:2-5)

    a. Brief definitions of income, exclusions, gross income, deductions for adjusted gross income, adjusted gross income, deductions from adjusted gross income, itemized deductions, standard deduction, personal and dependency exemptions, taxable income, tax rates, gross tax, and tax credits are presented with references to detailed coverage later in the text.

II. Deductions from Adjusted Gross Income

1. Itemized Deductions (Table I:2-6; Example I:2-2)

    a. The total of qualifying medical expenses, taxes, investment and residential interest, charitable contributions, personal casualty and theft losses, and miscellaneous deductions are claimed only if the total of such items exceeds the standard deduction.

    b. Deductions for medical expenses, charitable contributions, personal casualty and theft losses, and miscellaneous items are all limited by varying percentages of adjusted gross income.

2. Standard Deduction (Example I:2-3, I:2-4)

    a. The full amount of the standard deduction (which varies with filing status, age, and vision) may be claimed when it exceeds the taxpayer's itemized deductions.

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i. EXAMPLE: A single taxpayer in 2017 has $5,000 of allowable itemized deductions. Since the applicable standard deduction for this taxpayer ($6,350) is greater than his itemized deductions, the taxpayer deducts $6,350 in determining his taxable income.

Filing Status	**Standard Deduction**	
	2016	**2017**
Married couple filing jointly	$12,600	$12,700
Surviving spouse	12,600	12,700
Head of household	9,300	9,350
Single (unmarried individual other than surviving spouse or head of household)	6,300	6,350
Married individual filing separately	6,300	6,350

b. Additions to the standard deduction are available for taxpayers who are 65 or older and/or blind. The 2017 additions are $1,250 for married taxpayers and $1,550 for single taxpayer. These are the same amounts as in 2016.

i. EXAMPLE: A single taxpayer in 2017 who is 65 and blind would have a standard deduction of $9,450 [$6,350 + $1,550 (age) + $1,550 (blindness)].

3. Personal Exemptions

a. Unless claimed as a dependent on another return, each individual taxpayer is allowed a personal exemption ($4,050 in 2017, same as 2016). No personal exemption is allowed to a taxpayer who is claimed as a dependent on another return.

b. An additional personal exemption is allowed for the spouse on a joint return. On a separate return, if the spouse is not a dependent of another taxpayer and has no gross income, a personal exemption is also allowed for the spouse.

4. Dependency Exemptions (Example I:2-8, I:2-12, I:2-16, I:2-17, I:2-21; Topic Review I:2-1; Problem I:2-33)

a. A dependency exemption (also $4,050 in 2016) is allowed. Dependents must meet the following requirements:

i. Have a Social Security number reported on return;

ii. Be a U.S. Citizen, U.S. Resident, or reside in Canada or Mexico; and

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iii. Not have filed a joint return (unless filed for the sole purpose of obtaining a refund).

b. Additional requirements for "qualifying children"

i. Be a natural, adopted, foster child, or stepchild of the taxpayer, a sibling of the taxpayer, or descendants of any of the previous;

ii. Be under 19, a full-time student under age 24, or a permanently and totally disabled child;

iii. Have the same principal abode as taxpayer, and

iv. Dependent may not provide more than one half of his or her own support.

c. Additional requirements for "qualifying relatives" (See page I:2-17 for exceptions under multiple support agreements and parental releases)

i. Be related to the taxpayer or reside in the taxpayer's household for the entire year;

ii. Have gross income less than the exemption amount; and

iii. The taxpayer must normally provide more than one half of the dependent's support. (Receipts of the potential dependent are counted as support only if the receipts are spent for support, i.e., if the dependent puts all his social security payments in a savings account, the payments do not count in the support test.)

5. Child Credit (Example I:2-22; Problem I:2-52)

a. The child credit is $1,000 for each qualifying child (U.S. citizen/national/resident under 17 who qualifies as the taxpayer's dependent descendent, stepchild, or foster child).

b. The total credit for all children is reduced by $50 for each $1,000 (or fraction thereof) of AGI over $110,000 for married filing jointly, $75,000 for unmarried, and $55,000 for married filing separately.

c. Under certain circumstances, the credit is refundable.

III. Determining the Amount of Tax (Example I:2-24, I:2-25; Topic Review I:2-2; Problem I:2-49; Instructor Aid I:2-1)

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Gross tax is determined by applying the tax table (Appendix A) or tax rate schedule inside the front cover to the taxpayer's taxable income.

In 2017, tax brackets of 10%, 15%, 25%, 28%, 33%, 35%, and 39.6% are applicable to individual taxpayers. These are the same brackets used in 2016. The income level covered by the six brackets varies with filing status.

1. Joint Return

    a. A joint return may be filed by a man and woman if they are considered married for tax purposes on the last day of the tax year. Common law marriages and same-sex marriages are recognized. Annulled marriages are viewed as having never occurred.

    b. Taxpayers legally divorced at the end of the year may be treated as married for tax purposes, if the divorce is considered a sham.

        i. EXAMPLE: Taxpayers obtain a foreign divorce effective 12-30-2016 and remarry 1-2-2017. The only reason for the procedure was to improve tax filing status. The taxpayers will be treated as married for the tax year ending 12-31-2016.

2. Surviving Spouse (Example I:2-26)

    a. A widow or widower may file as a surviving spouse in the two years after the year the decedent spouse died if the surviving spouse:

        i. Has not remarried;

        ii. Is a U.S. citizen or resident;

        iii. Was qualified to file a joint return in the year of death; and

        iv. Paid over half the costs of maintaining a household in which a dependent child, adopted child, or stepchild lives during the entire tax year.

    b. The widow or widower may file jointly in the year of the spouse's death with the cooperation of the executor of the estate. Both the surviving spouse and the executor must sign any joint return. If either party does not agree to file a joint return, then they must file as married filing separately.

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c. The widow or widower may qualify as head of household in the years after the expiration of the surviving spouse status, assuming the surviving spouse meets the qualifications outlined below.

3. Head of Household (Example I:2-27)

   a. An individual may file as head of household if the individual:

      i. Is considered single for tax purposes (see abandoned spouse, below);

      ii. Is not a surviving spouse;

      iii. Is a U.S. citizen or resident; and

      iv. Pays over half the costs of maintaining a household in which a qualifying child or dependent relative lives for more than half of the tax year. Dependent parents may reside in a separate household, and children do not have to be tax dependents to qualify.

4. Single Taxpayer

   a. A taxpayer who does not qualify for any other filing status must file under the single status.

5. Married Filing Separately

   a. Married individuals may choose to file separate returns rather than one joint return. Separate returns will seldom provide the best overall tax results due to the higher rates. However, every married couple's tax should be computed using both the joint return rules and the separate return rules to insure the lowest overall tax.

6. Abandoned Spouse (Example I:2-30, I:2-31; Question I:2-18)

   a. A legally married individual may file as head-of-household if the individual:

      i. Lived apart from the spouse for the last 6 months of the year;

      ii. Pays over half of the cost of maintaining a household in which the taxpayer and a dependent child lived for over half the year; and

      iii. Is a U.S. citizen or resident.

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b. Without the abandoned spouse rule, the only alternative for the taxpayer would be to file married-separately (due to the unavailability of the absent spouse to prepare and sign a joint return). Head-of-household tax rates are significantly better than married-filing separately rates.

7. Dependents with Unearned Income (Example I:2-32, I:2-33; Problem I:2-57)

a. Dependents receive no personal exemption.

b. A dependent's standard deduction is the greater of $1,050 or the dependent's earned income plus $350.

c. For children under 18, unearned income in excess of $2,100 is taxed at the parent's marginal rates. Between the ages of 18 and 23, this "kiddie tax" only applies under certain circumstances (e.g., the child's earned income represents less than half of his or her support). For simplified situations, the kiddie tax can be reported and paid with the parents' return(s).

IV. Treatment of Capital Gains and Losses (Question I:2-21; Instructor Aid I:2-2)

1. Definition of Capital Assets

a. Capital assets are assets other than inventory; depreciable property used in a trade or business; real property used in a trade or business; copyrights or literary, musical, or artistic compositions in the hands of the creator or a donee of the creator; letters or memoranda; accounts or notes receivable from the ordinary course of a trade or business; or certain U.S. Government publications.

b. The tax definition of capital assets is significantly different from the financial accounting definition of capital assets (i.e., property, plant, & equipment).

2. Treatment of Gains and Losses

a. Net long-term capital gains (with a holding period greater than one year) are generally taxed at 0% for taxpayers in the 10% or 15% brackets, 20% for taxpayers in the 39.6% bracket, and 15% for all others. Net short-term capital gains are taxed at ordinary income. Net capital losses offset a maximum of $3,000 of other income, with an unlimited carryforward for individuals.

3. Provisions Applicable to Higher Income Taxpayers (Example I:2-38; I:2-39)

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a. A payroll tax of .9% and net investment income tax of 3.8% applies to certain high-income taxpayers.

b. Personal and dependency exemptions and certain itemized deductions are phased out for certain high-income taxpayers.

V. Tax Planning Considerations

1. Shifting Income Between Family Members (Example I:2-41, I:2-42, I:2-43)

   a. Shifting taxable income to family members to lower tax brackets will reduce the overall family tax burden.

   b. Restrictions apply to transactions that only involve assignment, and not shifting, of income, as well as transactions that trigger the kiddie tax.

2. Splitting Income (Example I:2-44)

   a. Creating additional taxpayers can reduce the overall tax burden, but administrative costs, especially of additional corporations, reduce the overall savings.

3. Maximizing Itemized Deductions (Example I:2-45, I:2-46)

   a. Itemized deductions only provide value to the extent that they exceed the standard deduction. Timing expenses, losses, and charitable contributions so that they fall in a single tax year can increase the value of the resulting deductions.

4. Filing Joint or Separate Returns (Examples I:2-49)

   a. Both tax and non-tax issues determine whether married couples should file jointly or separately.

   b. Spouses who file jointly are jointly liable for income tax, including the tax on disallowed deductions or unreported income. The innocent spouse provision protects spouses who were not aware of the magnitude of the understated tax liability, and the separate liability election allows spouses or former spouses to elect to be separately liable for the tax.

VI. Compliance and Procedural Considerations

1. Who Must File (Example I:2-50)

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a. Generally, the income limitation for filing can be determined by adding the standard deduction for a particular status to the amount for personal exemptions for that status. (See page I:2-35 for the gross income filing levels.)

i. EXAMPLE: For 2017, a single taxpayer (under 65, not blind, not a dependent on another return) must file a return when gross income exceeds $10,400 ($6,350 standard deduction plus $4,050 personal exemption). This amount is $50 higher than in 2016 because of a $50 increase in the standard deduction.

2. Due Dates and Extensions

a. Tax returns for calendar-year individual taxpayers (Forms 1040, 1040EZ, 1040A) are due April 15 (or first business day thereafter if April 15 is not a business day) following the end of the taxable year, with an automatic six-month extension if Form 4868 is filed by the due date for the return.

b. Forms 1040EZ and 1040A are used for taxpayers that have few complications in the tax year. Taxpayers with only salary, wages, and no more than $1,500 of interest may file using Form 1040EZ. Taxpayers with only salary, wages, dividends, interest, pensions and annuities, and unemployment income can file using Form 1040A. Both forms also have restrictions on deductions and credits allowed. All taxpayers may file using Form 1040.

c. Partnerships must file Form 1065 and S corporations must file Form 1120S by the fifteenth day of the third month following year end (i.e., March 15 for calendar-year-end taxpayers). C corporations must file Form 1120 and have the same due date as individual taxpayers. Any of these organizations can file Form 7004 to obtain a six-month extension. Prior to 2017, C corporation extensions were not necessarily six months.

d. An extension to file is not an extension on paying taxes. Interest and penalties apply for underpayment even when filing an extension.

3. Systems for Reporting Income

a. Payments made by certain entities are reported to the IRS for computer cross-checking that all income has been reported.

b. Items reported include pensions, annuities, wages, dividends, interest, sales of securities, unemployment compensation, rents, royalties, and lump-sum

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distributions from retirement plans. (See page I:2-36 for a list of forms on which different income types are reported to the taxpayer.)

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Court Case Briefs

Kenneth Royce Boykin v. CIR, 1984 PH T.C. Memo & 84,297, 48 TCM 267.

The taxpayer and his wife were divorced in February of 1979, but he continued to live with his former wife and their children after the divorce in 1979 and 1980. IRC Sec.143 provides that the "determination of whether an individual is married shall be made as of the close of his taxable year." IRC Sec.143 further provides that an individual legally separated by divorce or a separate maintenance decree is not considered married. The taxpayer was denied the filing status of married, filing jointly because he was not married at the close of the tax years at issue. Texas (state of residence) recognizes common law marriages that have the elements of mutual agreement, cohabitation, and the holding out of themselves as married to the public. Their cohabitation did not qualify because they had not mutually agreed to be remarried. However, he was permitted "head of household" filing status because he met the requirements of Sec. 2(b). He was not married at the close of the tax year and he maintained a household for over half of the tax year for his dependent children.

Cassius L. Peacock, III v. CIR, 1978 PH T.C Memo & 78,030, 37 TCM 177.

Cassius L. Peacock, III had never been married in any formal ceremony to the woman, Marie Jones, with whom he cohabited. Prior to the birth of their first child, however, he and his "spouse" signed an agreement to raise their children together. He claimed her as a dependency exemption on his 1974 federal tax return. The IRS disallowed this exemption on the grounds that their relationship was in violation of local law.

The court held that Marie was not the taxpayer's spouse within the meaning of '151 and, therefore, the taxpayer was not eligible to claim an exemption for her as his spouse. The court further held that Marie was not a member of Mr. Peacock's household for exemption purposes because "the relationship between such individual and the taxpayer is in violation of local law." (See Sec. 152(b(5))). The state law of Arizona provided that a person who "lives in a state of open and notorious cohabitation is guilty of a felony punishable by imprisonment in a state prison for not more than three years."

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Instructor Aid I:2-1

Relative Tax by Filing Status*

Lowest	Married Filing Jointly/Surviving Spouse
↓	Head of Household
	Single
Highest	Married Filing Separately**

*Assuming the same amount of taxable income.

**In the few cases where the married couple both has income and only one has substantial amounts of itemized deductions, the result may vary.

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Instructor Aid I:2-2

Capital Assets

Capital assets are defined in a negative manner under the Internal Revenue Code. Capital assets are assets that are not:

- Inventory
- Depreciable property used in a trade or business
- Real Property used in a trade or business
- Copyrights
- Literary, musical, or artistic compositions

In the hands of the creator or a donee of the creator

- Letters or memorandums
- Accounts or notes receivable from the ordinary course of a trade or business
- Certain U.S. Government publications

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Form **8615**

Department of the Treasury
Internal Revenue Service (99)

Tax for Certain Children Who Have Unearned Income

▶ **Attach only to the child's Form 1040, Form 1040A, or Form 1040NR.**
▶ **Information about Form 8615 and its separate instructions is at *www.irs.gov/form8615*.**

OMB No. 1545-0074

2016

Attachment Sequence No. **33**

Child's name shown on return: Aida Petosa

Child's social security number: 123-45-6789

Before you begin: If the child, the parent, or any of the parent's other children for whom Form 8615 must be filed must use the Schedule D Tax Worksheet or has income from farming or fishing, see **Pub. 929,** Tax Rules for Children and Dependents. It explains how to figure the child's tax using the **Schedule D Tax Worksheet** or **Schedule J** (Form 1040).

A Parent's name (first, initial, and last). **Caution:** *See instructions before completing.* Alfredo Petosa

B Parent's social security number 987-65-4321

C Parent's filing status (check one):
☐ Single ☐ Married filing jointly ☐ Married filing separately ☒ Head of household ☐ Qualifying widow(er)

Part I Child's Net Unearned Income

1	Enter the child's unearned income (see instructions)	1	2,800
2	If the child **did not** itemize deductions on **Schedule A** (Form 1040 or Form 1040NR), enter $2,100. Otherwise, see instructions	2	2,100
3	Subtract line 2 from line 1. If zero or less, **stop;** do not complete the rest of this form but **do** attach it to the child's return	3	700
4	Enter the child's **taxable income** from Form 1040, line 43; Form 1040A, line 27; or Form 1040NR, line 41. If the child files Form 2555 or 2555-EZ, see the instructions	4	1,750
5	Enter the **smaller** of line 3 or line 4. If zero, **stop;** do not complete the rest of this form but **do** attach it to the child's return	5	700

Part II Tentative Tax Based on the Tax Rate of the Parent

6	Enter the parent's **taxable income** from Form 1040, line 43; Form 1040A, line 27; Form 1040EZ, line 6; Form 1040NR, line 41; or Form 1040NR-EZ, line 14. If zero or less, enter -0-. If the parent files Form 2555 or 2555-EZ, see the instructions	6	52,000
7	Enter the total, if any, from Forms 8615, line 5, of **all other** children of the parent named above. **Do not** include the amount from line 5 above	7	0
8	Add lines 5, 6, and 7 (see instructions)	8	52,700
9	Enter the tax on the amount on line 8 based on the **parent's** filing status above (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	9	7,473*
10	Enter the parent's tax from Form 1040, line 44; Form 1040A, line 28, minus any alternative minimum tax; Form 1040EZ, line 10; Form 1040NR, line 42; or Form 1040NR-EZ, line 15. **Do not** include any tax from Form **4972, 6814,** or **8885** or any tax from recapture of an education credit. If the parent files Form 2555 or 2555-EZ, see the instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) was used to figure the tax, check here ▶ ☐	10	7,298*
11	Subtract line 10 from line 9 and enter the result. If line 7 is blank, also enter this amount on line 13 and go to **Part III**	11	175
12a	Add lines 5 and 7 — 12a: 700		
b	Divide line 5 by line 12a. Enter the result as a decimal (rounded to at least three places)	12b	×1.000
13	Multiply line 11 by line 12b	13	175

Part III Child's Tax—If lines 4 and 5 above are the same, enter -0- on line 15 and go to line 16.

14	Subtract line 5 from line 4 — 14: 1,050		
15	Enter the tax on the amount on line 14 based on the **child's** filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	15	105*
16	Add lines 13 and 15	16	280
17	Enter the tax on the amount on line 4 based on the **child's** filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	17	175*
18	Enter the **larger** of line 16 or line 17 here and on the **child's** Form 1040, line 44; Form 1040A, line 28; or Form 1040NR, line 42. If the child files Form 2555 or 2555-EZ, see the instructions	18	280

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 64113U Form **8615** (2016)

*From 2016 Tax Rate Schedule.

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Form **1040A** Department of the Treasury—Internal Revenue Service **U.S. Individual Income Tax Return** (99) **2016** IRS Use Only—Do not write or staple in this space.

OMB No. 1545-0074

Your first name and initial	Last name	Your social security number
Zachary L.	Mao	123 45 6789
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Cici K.	Mao	987 65 4321

Home address (number and street). If you have a P.O. box, see instructions. 520 Chestnut St. Apt. no.

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

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). Philadelphia, PA 19106

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

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

Filing status Check only one box.

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) with dependent child (see instructions)

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:** If more than six dependents, see instructions.

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
Oliver	Mao	111-22-3333	Son	☑
				☐
				☐
				☐
				☐
				☐

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

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

Income

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

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

7	Wages, salaries, tips, etc. Attach Form(s) W-2.	7	85,000
8a	**Taxable** interest. Attach Schedule B if required.	8a	200
b	**Tax-exempt** interest. **Do not** include on line 8a. 8b		
9a	Ordinary dividends. Attach Schedule B if required.	9a	
b	Qualified dividends (see instructions). 9b		
10	Capital gain distributions (see instructions).	10	
11a	IRA distributions. 11a	11b Taxable amount (see instructions). 11b	
12a	Pensions and annuities. 12a	12b Taxable amount (see instructions). 12b	
13	Unemployment compensation and Alaska Permanent Fund dividends.	13	
14a	Social security benefits. 14a	14b Taxable amount (see instructions). 14b	
15	Add lines 7 through 14b (far right column). This is your **total income.** ▶	15	85,200

Adjusted gross income

16	Educator expenses (see instructions). 16		
17	IRA deduction (see instructions). 17		
18	Student loan interest deduction (see instructions). 18		
19	Tuition and fees. Attach Form 8917. 19		
20	Add lines 16 through 19. These are your **total adjustments.**	20	
21	Subtract line 20 from line 15. This is your **adjusted gross income.** ▶	21	85,200

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11327A Form **1040A** (2016)

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Form 1040A (2016) Page **2**

Tax, credits, and payments

22	Enter the amount from line 21 (adjusted gross income).			22	85,200
23a	Check if: ☐ **You** were born before January 2, 1952, ☐ Blind; ☐ **Spouse** was born before January 2, 1952, ☐ Blind. **Total boxes checked** ▶ 23a				
b	If you are married filing separately and your spouse itemizes deductions, check here ▶ 23b ☐				
24	Enter your **standard deduction.**			24	12,600
25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.			25	72,600
26	**Exemptions.** Multiply $4,050 by the number on line 6d.			26	12,150
27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your **taxable income.** ▶			27	60,450
28	**Tax,** including any alternative minimum tax (see instructions).	28	8,140 *		
29	Excess advance premium tax credit repayment. Attach Form 8962.	29			
30	Add lines 28 and 29.			30	8,140
31	Credit for child and dependent care expenses. Attach Form 2441.	31			
32	Credit for the elderly or the disabled. Attach Schedule R.	32			
33	Education credits from Form 8863, line 19.	33			
34	Retirement savings contributions credit. Attach Form 8880.	34			
35	Child tax credit. Attach Schedule 8812, if required.	35	1,000		
36	Add lines 31 through 35. These are your **total credits.**			36	1,000
37	Subtract line 36 from line 30. If line 36 is more than line 30, enter -0-.			37	7,140
38	Health care: individual responsibility (see instructions). Full-year coverage ☒			38	
39	Add line 37 and line 38. This is your **total tax.**			39	7,140
40	Federal income tax withheld from Forms W-2 and 1099.	40	8,000		
41	2016 estimated tax payments and amount applied from 2015 return.	41			
42a	**Earned income credit (EIC).**	42a			
b	Nontaxable combat pay election. 42b				
43	Additional child tax credit. Attach Schedule 8812.	43			
44	American opportunity credit from Form 8863, line 8.	44			
45	Net premium tax credit. Attach Form 8962.	45			
46	Add lines 40, 41, 42a, 43, 44, and 45. These are your **total payments.** ▶			46	8,000

Standard Deduction for—
- People who check any box on line 23a or 23b **or** who can be claimed as a dependent, see instructions.
- All others:

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

If you have a qualifying child, attach Schedule EIC.

Refund

Direct deposit? See instructions and fill in 48b, 48c, and 48d or Form 8888.

47	If line 46 is more than line 39, subtract line 39 from line 46. This is the amount you **overpaid.**			47	860
48a	Amount of line 47 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐			48a	860
▶ b	Routing number ☐☐☐☐☐☐☐☐☐ ▶ c Type: ☐ Checking ☐ Savings				
▶ d	Account number ☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐				
49	Amount of line 47 you want **applied to your 2017 estimated tax.**	49			

Amount you owe

50	**Amount you owe.** Subtract line 46 from line 39. For details on how to pay, see instructions. ▶			50	
51	Estimated tax penalty (see instructions).	51			

Third party designee

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

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

Sign here

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

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

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

Paid preparer use only

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

Form **1040A** (2016)

*From 2016 Tax Rate Schedule.

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Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2016** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2016, or other tax year beginning , 2016, ending , 20 See separate instructions.

Your first name and initial	Last name	Your social security number
John R.	Lane	111 44 6666
If a joint return, spouse's first name and initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.
1010 Ipsen Street

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

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).
Yorba Linda, CA 90102

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

Presidential Election Campaign
Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☑ You ☐ Spouse

Filing Status

Check only one box.

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) with dependent child

Exemptions

6a ☑ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

Boxes checked on 6a and 6b: 1

c **Dependents:**

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

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

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

d Total number of exemptions claimed — Add numbers on lines above ▶ 1

Income

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

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

7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	20,000
8a	**Taxable** interest. Attach Schedule B if required			8a	300
b	**Tax-exempt** interest. **Do not** include on line 8a	8b			
9a	Ordinary dividends. Attach Schedule B if required			9a	
b	Qualified dividends	9b			
10	Taxable refunds, credits, or offsets of state and local income taxes			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			13	
14	Other gains or (losses). Attach Form 4797			14	
15a	IRA distributions	15a	b Taxable amount	15b	
16a	Pensions and annuities	16a 31,000	b Taxable amount	16b	31,000
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation			19	
20a	Social security benefits	20a	b Taxable amount	20b	
21	Other income. List type and amount			21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶			22	51,300

Adjusted Gross Income

23	Educator expenses	23			
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24			
25	Health savings account deduction. Attach Form 8889	25			
26	Moving expenses. Attach Form 3903	26			
27	Deductible part of self-employment tax. Attach Schedule SE	27			
28	Self-employed SEP, SIMPLE, and qualified plans	28			
29	Self-employed health insurance deduction	29			
30	Penalty on early withdrawal of savings	30			
31a	Alimony paid b Recipient's SSN ▶	31a			
32	IRA deduction	32	5,500		
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	5,500
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶			37	45,800

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Form 1040 (2016) Page 2

Tax and Credits	38	Amount from line 37 (adjusted gross income)		38	45,800
	39a	Check if: [X] **You** were born before January 2, 1952, [ ] Blind. [ ] **Spouse** was born before January 2, 1952, [ ] Blind. **Total boxes checked ▶ 39a** 1			
	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b [ ]			
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,300 Married filing jointly or Qualifying widow(er), $12,600 Head of household, $9,300	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40	8,000
	41	Subtract line 40 from line 38		41	37,800
	42	**Exemptions.** If line 38 is $155,650 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions		42	4,050*
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	33,750
	44	**Tax** (see instructions). Check if any from: **a** [ ] Form(s) 8814 **b** [ ] Form 4972 **c** [ ]		44	4,599**
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
	46	Excess advance premium tax credit repayment. Attach Form 8962		46	
	47	Add lines 44, 45, and 46 ▶		47	4,599
	48	Foreign tax credit. Attach Form 1116 if required	48		
	49	Credit for child and dependent care expenses. Attach Form 2441	49		
	50	Education credits from Form 8863, line 19	50		
	51	Retirement savings contributions credit. Attach Form 8880	51		
	52	Child tax credit. Attach Schedule 8812, if required	52		
	53	Residential energy credits. Attach Form 5695	53		
	54	Other credits from Form: **a** [ ] 3800 **b** [ ] 8801 **c** [ ]	54		
	55	Add lines 48 through 54. These are your **total credits**		55	
	56	Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- ▶		56	4,599
Other Taxes	57	Self-employment tax. Attach Schedule SE		57	
	58	Unreported social security and Medicare tax from Form: **a** [ ] 4137 **b** [ ] 8919		58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		59	
	60a	Household employment taxes from Schedule H		60a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		60b	
	61	Health care: individual responsibility (see instructions) Full-year coverage [X]		61	
	62	Taxes from: **a** [ ] Form 8959 **b** [ ] Form 8960 **c** [ ] Instructions; enter code(s)		62	
	63	Add lines 56 through 62. This is your **total tax** ▶		63	4,599
Payments	64	Federal income tax withheld from Forms W-2 and 1099	64 6,000		
If you have a qualifying child, attach Schedule EIC.	65	2016 estimated tax payments and amount applied from 2015 return	65		
	66a	**Earned income credit (EIC)**	66a		
	b	Nontaxable combat pay election 66b			
	67	Additional child tax credit. Attach Schedule 8812	67		
	68	American opportunity credit from Form 8863, line 8	68		
	69	Net premium tax credit. Attach Form 8962	69		
	70	Amount paid with request for extension to file	70		
	71	Excess social security and tier 1 RRTA tax withheld	71		
	72	Credit for federal tax on fuels. Attach Form 4136	72		
	73	Credits from Form: **a** [ ] 2439 **b** [ ] Reserved **c** [ ] 8885 **d** [ ]	73		
	74	Add lines 64, 65, 66a, and 67 through 73. These are your **total payments** ▶		74	6,000
Refund	75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**		75	1,401
	76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ [ ]		76a	1,401
Direct deposit? See instructions.	▶ b	Routing number ▶ c Type: [ ] Checking [ ] Savings			
	▶ d	Account number			
	77	Amount of line 75 you want **applied to your 2017 estimated tax** ▶	77		
Amount You Owe	78	**Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶		78	
	79	Estimated tax penalty (see instructions)	79		

Third Party Designee Do you want to allow another person to discuss this return with the IRS (see instructions)? [ ] **Yes.** Complete below. [X] **No**

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

Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

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

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

Paid Preparer Use Only

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

www.irs.gov/form1040 Form **1040** (2016)

*A cousin is not a qualifying relative if he or she does not live with the taxpayer.

**From 2016 Tax Rate Schedule.

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Form **8615**

Department of the Treasury
Internal Revenue Service (99)

Tax for Certain Children Who Have Unearned Income

▶ **Attach only to the child's Form 1040, Form 1040A, or Form 1040NR.**
▶ **Information about Form 8615 and its separate instructions is at *www.irs.gov/form8615*.**

OMB No. 1545-0074

2016

Attachment Sequence No. **33**

Child's name shown on return: Aida Petosa

Child's social security number: 123-45-6789

Before you begin: If the child, the parent, or any of the parent's other children for whom Form 8615 must be filed must use the Schedule D Tax Worksheet or has income from farming or fishing, see **Pub. 929,** Tax Rules for Children and Dependents. It explains how to figure the child's tax using the **Schedule D Tax Worksheet** or **Schedule J** (Form 1040).

A Parent's name (first, initial, and last). **Caution:** *See instructions before completing.* Alfredo Petosa

B Parent's social security number 987-65-4321

C Parent's filing status (check one):
☐ Single ☐ Married filing jointly ☐ Married filing separately ☒ Head of household ☐ Qualifying widow(er)

Part I Child's Net Unearned Income

1	Enter the child's unearned income (see instructions)	1	2,800
2	If the child **did not** itemize deductions on **Schedule A** (Form 1040 or Form 1040NR), enter $2,100. Otherwise, see instructions	2	2,100
3	Subtract line 2 from line 1. If zero or less, **stop;** do not complete the rest of this form but **do** attach it to the child's return	3	700
4	Enter the child's **taxable income** from Form 1040, line 43; Form 1040A, line 27; or Form 1040NR, line 41. If the child files Form 2555 or 2555-EZ, see the instructions	4	1,750
5	Enter the **smaller** of line 3 or line 4. If zero, **stop;** do not complete the rest of this form but **do** attach it to the child's return	5	700

Part II Tentative Tax Based on the Tax Rate of the Parent

6	Enter the parent's **taxable income** from Form 1040, line 43; Form 1040A, line 27; Form 1040EZ, line 6; Form 1040NR, line 41; or Form 1040NR-EZ, line 14. If zero or less, enter -0-. If the parent files Form 2555 or 2555-EZ, see the instructions	6	52,000
7	Enter the total, if any, from Forms 8615, line 5, of **all other** children of the parent named above. **Do not** include the amount from line 5 above	7	0
8	Add lines 5, 6, and 7 (see instructions)	8	52,700
9	Enter the tax on the amount on line 8 based on the **parent's** filing status above (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	9	7,473*
10	Enter the parent's tax from Form 1040, line 44; Form 1040A, line 28, minus any alternative minimum tax; Form 1040EZ, line 10; Form 1040NR, line 42; or Form 1040NR-EZ, line 15. **Do not** include any tax from Form **4972, 6814,** or **8885** or any tax from recapture of an education credit. If the parent files Form 2555 or 2555-EZ, see the instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) was used to figure the tax, check here ▶ ☐	10	7,298*
11	Subtract line 10 from line 9 and enter the result. If line 7 is blank, also enter this amount on line 13 and go to **Part III**	11	175
12a	Add lines 5 and 7 — 12a: 700		
b	Divide line 5 by line 12a. Enter the result as a decimal (rounded to at least three places)	12b	×1.000
13	Multiply line 11 by line 12b	13	175

Part III Child's Tax—If lines 4 and 5 above are the same, enter -0- on line 15 and go to line 16.

14	Subtract line 5 from line 4 — 14: 1,050		
15	Enter the tax on the amount on line 14 based on the **child's** filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	15	105*
16	Add lines 13 and 15	16	280
17	Enter the tax on the amount on line 4 based on the **child's** filing status (see instructions). If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐	17	175*
18	Enter the **larger** of line 16 or line 17 here and on the **child's** Form 1040, line 44; Form 1040A, line 28; or Form 1040NR, line 42. If the child files Form 2555 or 2555-EZ, see the instructions	18	280

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 64113U Form **8615** (2016)

*From 2016 Tax Rate Schedule.

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Form **1040A** Department of the Treasury—Internal Revenue Service **U.S. Individual Income Tax Return** (99) **2016** IRS Use Only—Do not write or staple in this space.

OMB No. 1545-0074

Your first name and initial	Last name	Your social security number
Zachary L.	Mao	123 45 6789
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Cici K.	Mao	987 65 4321

Home address (number and street). If you have a P.O. box, see instructions. 520 Chestnut St. Apt. no.

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

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). Philadelphia, PA 19106

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

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

Filing status Check only one box.

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) with dependent child (see instructions)

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:** If more than six dependents, see instructions.

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
Oliver	Mao	111-22-3333	Son	☑
				☐
				☐
				☐
				☐
				☐

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

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

Income

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

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

7	Wages, salaries, tips, etc. Attach Form(s) W-2.	7	85,000
8a	**Taxable** interest. Attach Schedule B if required.	8a	200
b	**Tax-exempt** interest. **Do not** include on line 8a. 8b		
9a	Ordinary dividends. Attach Schedule B if required.	9a	
b	Qualified dividends (see instructions). 9b		
10	Capital gain distributions (see instructions).	10	
11a	IRA distributions. 11a	11b Taxable amount (see instructions). 11b	
12a	Pensions and annuities. 12a	12b Taxable amount (see instructions). 12b	
13	Unemployment compensation and Alaska Permanent Fund dividends.	13	
14a	Social security benefits. 14a	14b Taxable amount (see instructions). 14b	
15	Add lines 7 through 14b (far right column). This is your **total income.** ▶	15	85,200

Adjusted gross income

16	Educator expenses (see instructions). 16		
17	IRA deduction (see instructions). 17		
18	Student loan interest deduction (see instructions). 18		
19	Tuition and fees. Attach Form 8917. 19		
20	Add lines 16 through 19. These are your **total adjustments.**	20	
21	Subtract line 20 from line 15. This is your **adjusted gross income.** ▶	21	85,200

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11327A Form **1040A** (2016)

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Form 1040A (2016) Page **2**

Tax, credits, and payments

22	Enter the amount from line 21 (adjusted gross income).			22	85,200
23a	Check if: ☐ **You** were born before January 2, 1952, ☐ Blind; ☐ **Spouse** was born before January 2, 1952, ☐ Blind. **Total boxes checked** ▶ 23a				
b	If you are married filing separately and your spouse itemizes deductions, check here ▶ 23b ☐				
24	Enter your **standard deduction.**			24	12,600
25	Subtract line 24 from line 22. If line 24 is more than line 22, enter -0-.			25	72,600
26	**Exemptions.** Multiply $4,050 by the number on line 6d.			26	12,150
27	Subtract line 26 from line 25. If line 26 is more than line 25, enter -0-. This is your **taxable income.** ▶			27	60,450
28	**Tax,** including any alternative minimum tax (see instructions).	28	8,140 *		
29	Excess advance premium tax credit repayment. Attach Form 8962.	29			
30	Add lines 28 and 29.			30	8,140
31	Credit for child and dependent care expenses. Attach Form 2441.	31			
32	Credit for the elderly or the disabled. Attach Schedule R.	32			
33	Education credits from Form 8863, line 19.	33			
34	Retirement savings contributions credit. Attach Form 8880.	34			
35	Child tax credit. Attach Schedule 8812, if required.	35	1,000		
36	Add lines 31 through 35. These are your **total credits.**			36	1,000
37	Subtract line 36 from line 30. If line 36 is more than line 30, enter -0-.			37	7,140
38	Health care: individual responsibility (see instructions). Full-year coverage ☒			38	
39	Add line 37 and line 38. This is your **total tax.**			39	7,140
40	Federal income tax withheld from Forms W-2 and 1099.	40	8,000		
41	2016 estimated tax payments and amount applied from 2015 return.	41			
42a	**Earned income credit (EIC).**	42a			
b	Nontaxable combat pay election. 42b				
43	Additional child tax credit. Attach Schedule 8812.	43			
44	American opportunity credit from Form 8863, line 8.	44			
45	Net premium tax credit. Attach Form 8962.	45			
46	Add lines 40, 41, 42a, 43, 44, and 45. These are your **total payments.** ▶			46	8,000

Standard Deduction for—
- People who check any box on line 23a or 23b **or** who can be claimed as a dependent, see instructions.
- All others:

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

If you have a qualifying child, attach Schedule EIC.

Refund

Direct deposit? See instructions and fill in 48b, 48c, and 48d or Form 8888.

47	If line 46 is more than line 39, subtract line 39 from line 46. This is the amount you **overpaid.**			47	860
48a	Amount of line 47 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐			48a	860
▶ b	Routing number ☐☐☐☐☐☐☐☐☐ ▶ c Type: ☐ Checking ☐ Savings				
▶ d	Account number ☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐				
49	Amount of line 47 you want **applied to your 2017 estimated tax.**	49			

Amount you owe

50	**Amount you owe.** Subtract line 46 from line 39. For details on how to pay, see instructions. ▶			50	
51	Estimated tax penalty (see instructions).	51			

Third party designee

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

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

Sign here

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

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

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

Paid preparer use only

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

Form **1040A** (2016)

*From 2016 Tax Rate Schedule.

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Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2016** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2016, or other tax year beginning , 2016, ending , 20 See separate instructions.

Your first name and initial	Last name	Your social security number
John R.	Lane	111 44 6666
If a joint return, spouse's first name and initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. Apt. no.
1010 Ipsen Street

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

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).
Yorba Linda, CA 90102

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

Presidential Election Campaign
Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☑ You ☐ Spouse

Filing Status

Check only one box.

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) with dependent child

Exemptions

6a ☑ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

Boxes checked on 6a and 6b: 1

c **Dependents:**

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

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

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

d Total number of exemptions claimed — Add numbers on lines above ▶ 1

Income

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

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

7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	20,000
8a	**Taxable** interest. Attach Schedule B if required			8a	300
b	**Tax-exempt** interest. **Do not** include on line 8a	8b			
9a	Ordinary dividends. Attach Schedule B if required			9a	
b	Qualified dividends	9b			
10	Taxable refunds, credits, or offsets of state and local income taxes			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			13	
14	Other gains or (losses). Attach Form 4797			14	
15a	IRA distributions	15a	b Taxable amount	15b	
16a	Pensions and annuities	16a 31,000	b Taxable amount	16b	31,000
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation			19	
20a	Social security benefits	20a	b Taxable amount	20b	
21	Other income. List type and amount			21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶			22	51,300

Adjusted Gross Income

23	Educator expenses	23			
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24			
25	Health savings account deduction. Attach Form 8889	25			
26	Moving expenses. Attach Form 3903	26			
27	Deductible part of self-employment tax. Attach Schedule SE	27			
28	Self-employed SEP, SIMPLE, and qualified plans	28			
29	Self-employed health insurance deduction	29			
30	Penalty on early withdrawal of savings	30			
31a	Alimony paid b Recipient's SSN ▶	31a			
32	IRA deduction	32	5,500		
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	5,500
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶			37	45,800

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Form 1040 (2016) Page 2

Tax and Credits	38	Amount from line 37 (adjusted gross income)		38	45,800
	39a	Check if: [X] **You** were born before January 2, 1952, [ ] Blind. [ ] **Spouse** was born before January 2, 1952, [ ] Blind. **Total boxes checked ▶ 39a** 1			
	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b [ ]			
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,300 Married filing jointly or Qualifying widow(er), $12,600 Head of household, $9,300	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40	8,000
	41	Subtract line 40 from line 38		41	37,800
	42	**Exemptions.** If line 38 is $155,650 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions		42	4,050*
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	33,750
	44	**Tax** (see instructions). Check if any from: **a** [ ] Form(s) 8814 **b** [ ] Form 4972 **c** [ ]		44	4,599**
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
	46	Excess advance premium tax credit repayment. Attach Form 8962		46	
	47	Add lines 44, 45, and 46 ▶		47	4,599
	48	Foreign tax credit. Attach Form 1116 if required	48		
	49	Credit for child and dependent care expenses. Attach Form 2441	49		
	50	Education credits from Form 8863, line 19	50		
	51	Retirement savings contributions credit. Attach Form 8880	51		
	52	Child tax credit. Attach Schedule 8812, if required	52		
	53	Residential energy credits. Attach Form 5695	53		
	54	Other credits from Form: **a** [ ] 3800 **b** [ ] 8801 **c** [ ]	54		
	55	Add lines 48 through 54. These are your **total credits**		55	
	56	Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- ▶		56	4,599
Other Taxes	57	Self-employment tax. Attach Schedule SE		57	
	58	Unreported social security and Medicare tax from Form: **a** [ ] 4137 **b** [ ] 8919		58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		59	
	60a	Household employment taxes from Schedule H		60a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		60b	
	61	Health care: individual responsibility (see instructions) Full-year coverage [X]		61	
	62	Taxes from: **a** [ ] Form 8959 **b** [ ] Form 8960 **c** [ ] Instructions; enter code(s)		62	
	63	Add lines 56 through 62. This is your **total tax** ▶		63	4,599
Payments	64	Federal income tax withheld from Forms W-2 and 1099	64 6,000		
If you have a qualifying child, attach Schedule EIC.	65	2016 estimated tax payments and amount applied from 2015 return	65		
	66a	**Earned income credit (EIC)**	66a		
	b	Nontaxable combat pay election 66b			
	67	Additional child tax credit. Attach Schedule 8812	67		
	68	American opportunity credit from Form 8863, line 8	68		
	69	Net premium tax credit. Attach Form 8962	69		
	70	Amount paid with request for extension to file	70		
	71	Excess social security and tier 1 RRTA tax withheld	71		
	72	Credit for federal tax on fuels. Attach Form 4136	72		
	73	Credits from Form: **a** [ ] 2439 **b** [ ] Reserved **c** [ ] 8885 **d** [ ]	73		
	74	Add lines 64, 65, 66a, and 67 through 73. These are your **total payments** ▶		74	6,000
Refund	75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**		75	1,401
	76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ [ ]		76a	1,401
Direct deposit? See instructions.	▶ b	Routing number ▶ c Type: [ ] Checking [ ] Savings			
	▶ d	Account number			
	77	Amount of line 75 you want **applied to your 2017 estimated tax** ▶	77		
Amount You Owe	78	**Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶		78	
	79	Estimated tax penalty (see instructions)	79		

Third Party Designee Do you want to allow another person to discuss this return with the IRS (see instructions)? [ ] **Yes.** Complete below. [X] **No**

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

Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

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

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

Paid Preparer Use Only

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

www.irs.gov/form1040 Form **1040** (2016)

*A cousin is not a qualifying relative if he or she does not live with the taxpayer.

**From 2016 Tax Rate Schedule.

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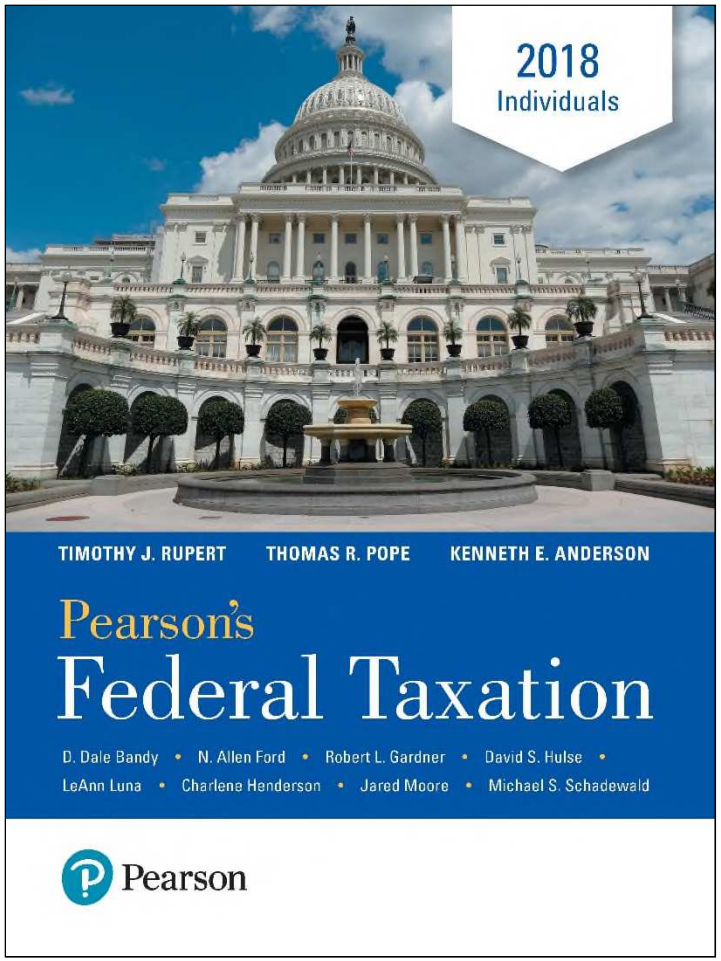
Pearson's Federal Taxation 2018: Individuals

Thirty-First Edition



Chapter 2

Determination of Tax

Pearson

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Learning Objectives (1 of 2)

2.1 Use the tax formula to compute an individual's taxable income

2.2 Determine the amount of deductions from Adjusted Gross Income

2.3 Calculate the income tax for individuals

2.4 Explain the basic income tax rules relating to business entities

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Learning Objectives (2 of 2)

2.5 Explain the basic income tax rules of capital gains and losses

2.6 Compute the income tax for high-income individuals

2.7 Describe tax planning considerations for various tax matters

2.8 Describe compliance and procedural matters for filing tax returns

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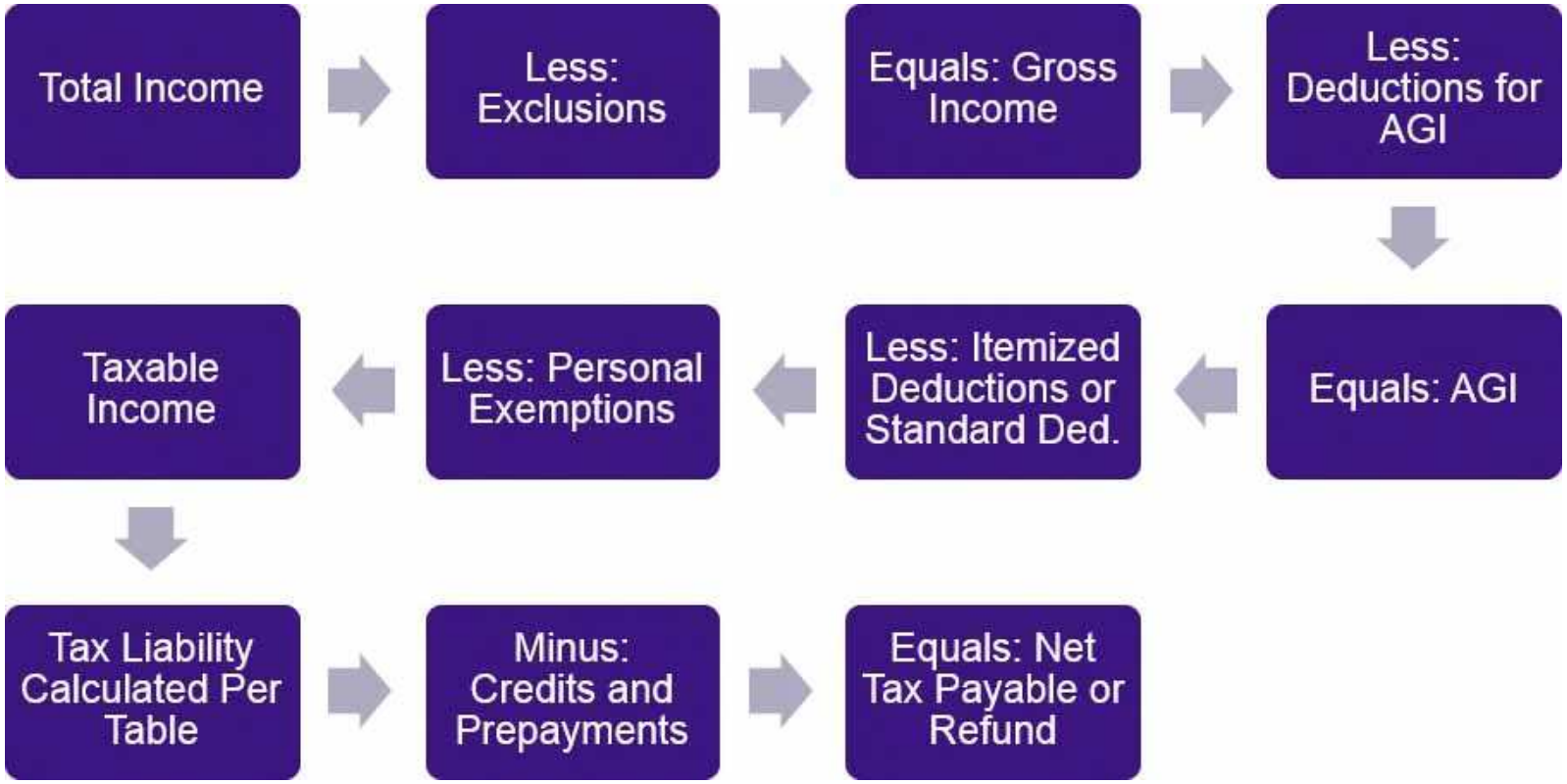
Basic Formula for Calculating Income Tax (1 of 3)



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Basic Formula for Calculating Income Tax (2 of 3)

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2016** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2016, or other tax year beginning , 2016, ending , 20 See separate instructions.

Your first name and initial: Larry S.	Last name: Lane	Your social security number: 123 45 6789
If a joint return, spouse's first name and initial: Jane V.	Last name: Lane	Spouse's social security number: 987 65 4321
Home address (number and street). If you have a P.O. box, see instructions.: 116 E. Edwards	Apt. no.	▲ Make sure the SSN(s) above and on line 6c are correct.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).: Lubbock, Texas 40401		Presidential Election Campaign: Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
Foreign country name	Foreign province/state/county	Foreign postal code

Filing Status Check only one box.

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) with dependent child

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) ✓ if child under age 17 qualifying for child tax credit (see instructions)
Betty	Lane	111 22 3333	Daughter	☒
				☐
				☐
				☐

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): 1

Dependents on 6c not entered above:

d Total number of exemptions claimed

Add numbers on lines above ▶ 3

Income

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

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

7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	78,000
8a	**Taxable** interest. Attach Schedule B if required			8a	4,000
b	**Tax-exempt** interest. **Do not** include on line 8a	8b	500		
9a	Ordinary dividends. Attach Schedule B if required			9a	
b	Qualified dividends	9b			
10	Taxable refunds, credits, or offsets of state and local income taxes			10	
11	Alimony received			11	
12	Business income or (loss). Attach Schedule C or C-EZ			12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			13	
14	Other gains or (losses). Attach Form 4797			14	
15a	IRA distributions 15a		b Taxable amount	15b	
16a	Pensions and annuities 16a		b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
18	Farm income or (loss). Attach Schedule F			18	
19	Unemployment compensation			19	
20a	Social security benefits 20a		b Taxable amount	20b	
21	Other income. List type and amount			21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶			22	82,000

Adjusted Gross Income

23	Educator expenses	23			
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24			
25	Health savings account deduction. Attach Form 8889	25			
26	Moving expenses. Attach Form 3903	26			
27	Deductible part of self-employment tax. Attach Schedule SE	27			
28	Self-employed SEP, SIMPLE, and qualified plans	28			
29	Self-employed health insurance deduction	29			
30	Penalty on early withdrawal of savings	30			
31a	Alimony paid b Recipient's SSN ▶	31a			
32	IRA deduction	32	5,500		
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	5,500
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶			37	76,500

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2016)

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Basic Formula for Calculating Income Tax (3 of 3)

Form 1040 (2016) Page 2

Tax and Credits	38	Amount from line 37 (adjusted gross income)		38	76,500
	39a	Check if: ☐ You were born before January 2, 1952, ☐ Blind. ☐ Spouse was born before January 2, 1952, ☐ Blind. Total boxes checked ▶ 39a			
	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b ☐			
Standard Deduction for— • People who check any box on line 39a or 39b or who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,300 Married filing jointly or Qualifying widow(er), $12,600 Head of household, $9,300	40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)		40	15,300
	41	Subtract line 40 from line 38		41	61,200
	42	Exemptions. If line 38 is $155,650 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions		42	12,150
	43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	49,050
	44	Tax (see instructions). Check if any from: a ☐ Form(s) 8814 b ☐ Form 4972 c ☐		44	6,434
	45	Alternative minimum tax (see instructions). Attach Form 6251		45	
	46	Excess advance premium tax credit repayment. Attach Form 8962		46	
	47	Add lines 44, 45, and 46 ▶		47	6,434
	48	Foreign tax credit. Attach Form 1116 if required	48		
	49	Credit for child and dependent care expenses. Attach Form 2441	49		
	50	Education credits from Form 8863, line 19	50		
	51	Retirement savings contributions credit. Attach Form 8880	51		
	52	Child tax credit. Attach Schedule 8812, if required	52	1,000	
	53	Residential energy credits. Attach Form 5695	53		
	54	Other credits from Form: a ☐ 3800 b ☐ 8801 c ☐	54		54
	55	Add lines 48 through 54. These are your total credits		55	1,000
	56	Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- ▶		56	5,434
Other Taxes	57	Self-employment tax. Attach Schedule SE		57	
	58	Unreported social security and Medicare tax from Form: a ☐ 4137 b ☐ 8919		58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		59	
	60a	Household employment taxes from Schedule H		60a	
	b	First-time homebuyer credit repayment. Attach Form 5405 if required		60b	
	61	Health care: individual responsibility (see instructions) Full-year coverage ☑		61	
	62	Taxes from: a ☐ Form 8959 b ☐ Form 8960 c ☐ Instructions; enter code(s)		62	
	63	Add lines 56 through 62. This is your total tax ▶		63	5,434
Payments	64	Federal income tax withheld from Forms W-2 and 1099	64	6,000	
If you have a qualifying child, attach Schedule EIC.	65	2016 estimated tax payments and amount applied from 2015 return	65		
	66a	Earned income credit (EIC)	66a		
	b	Nontaxable combat pay election 66b			
	67	Additional child tax credit. Attach Schedule 8812	67		
	68	American opportunity credit from Form 8863, line 8	68		
	69	Net premium tax credit. Attach Form 8962	69		
	70	Amount paid with request for extension to file	70		
	71	Excess social security and tier 1 RRTA tax withheld	71		
	72	Credit for federal tax on fuels. Attach Form 4136	72		
	73	Credits from Form: a ☐ 2439 b ☐ Reserved c ☐ 8885 d ☐	73		
	74	Add lines 64, 65, 66a, and 67 through 73. These are your total payments ▶		74	6,000
Refund	75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you overpaid		75	566
	76a	Amount of line 75 you want refunded to you. If Form 8888 is attached, check here ▶ ☐		76a	566
Direct deposit? See instructions.	b	▶ Routing number ▶ c Type: ☐ Checking ☐ Savings			
	d	▶ Account number			
	77	Amount of line 75 you want applied to your 2017 estimated tax ▶	77		
Amount You Owe	78	Amount you owe. Subtract line 74 from line 63. For details on how to pay, see instructions ▶		78	
	79	Estimated tax penalty (see instructions)	79		

Third Party Designee Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ Yes. Complete below. ☐ No
Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

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

Your signature	Date	Your occupation	Daytime phone number
Larry S. Lane	4/15/17	Attorney	555-555-1212
Spouse's signature. If a joint return, both must sign. Jane V. Lane	4/15/17	Spouse's occupation Student	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

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

www.irs.gov/form1040 Form 1040 (2016)

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Total Income

- Any “income from whatever source derived.”
- Includes both taxable and non-taxable income.
- Does NOT include return of capital (basis) of property sold.
- Example: Bob sells a piece of property for $1,000. He has a cost basis of $700. Bob will include $300, not $1,000, in total income.

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Exclusions

- Gifts
- Life Insurance
- Welfare
- Certain Scholarships
- Certain Pmts for Injury
- Certain Employee Benefits
- Certain Foreign Income
- Tax-Exempt Interest
- Series EE Bond Interest
- Leasehold Improvements
- Meritorious Achievement Awards
- Certain Divorce Payments
- Gain from Sale of Home
- Roth IRA Distributions
- COD
- SS Benefits

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Gross Income Items per § 61

- Wages
- Business Gross Inc.
- Gains from Property Sales
- Interest
- Rents
- Royalties
- Dividends
- Alimony
- Annuities
- Life Insurance Proceeds
- Pensions
- COD Income
- Partnership Income
- IRD
- Trust/Estate Income

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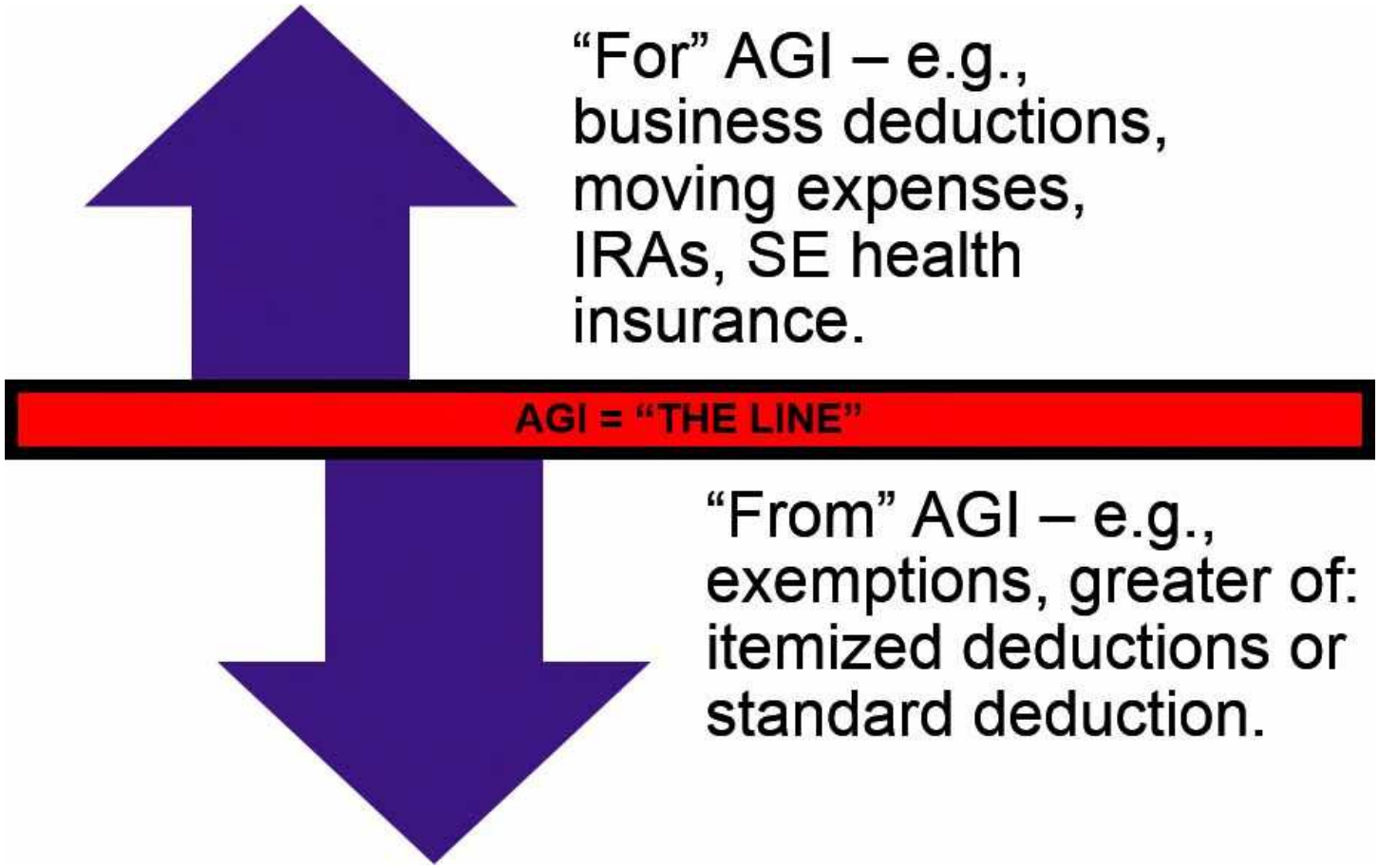
“For” vs. “From” AGI



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Deductions "For" AGI = § 62

- T & B Deductions
- Reimbursed EE Expenses
- Loss from Property Sales
- Rent/Royalty Deductions
- LT and Inc. Beneficiary Property Ded.
- Retirement Plan Contrib.
- Penalties from Savings Accts
- ½ S-E Taxes
- S-E Health Insurance Premiums
- Alimony
- Moving Exp.
- Repayments of Unemployment Compensation
- Certain Jury Duty Pay
- Certain Environmental Expenditures
- Interest on Student Loans
- Medical Savings Account Contributions

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Deductions "From" AGI

- Taxpayer can deduct greater of: Itemized Deductions OR Standard Deduction.
- Can also deduct personal and dependency exemptions.
- Exemptions = $4,050 per person for 2017.

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Itemized vs. Standard Deduction (2017 Amounts)

Itemized Deductions

- Medical Expenses
- Taxes – Property, Real Estate, S&L
- Charitable Contributions
- Casualty Losses
- Mortgage Interest
- Miscellaneous Deduction

Standard Deductions

- Single = $6,350
- Head of Household = $9,350
- Married Filing Separately = $6,350
- Married Filing Jointly = $12,700
- Increases to S/D if elderly or blind.

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Itemized Deductions – Not Subject to Thresholds (1 of 2)

- Mortgage Interest.
- Charitable Contributions (limited).
- Property, State/Local, and Real Estate Taxes.
- Investment Interest (limited).

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Itemized Deductions – Not Subject to Thresholds (2 of 2)

- Miscellaneous Deductions NOT subject to 2% AGI:
  - Estate taxes for IRD.
  - Gambling losses to the extent of gambling income.
  - Amortization of bond premium.
  - Amounts restored under claim of right.

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Itemized Deductions – Subject to Floors

- Medical Expenses – Can only deduct amounts over 10% threshold (2017).
- Miscellaneous Itemized Deductions – 2% AGI.
- Casualty Losses – 10% AGI.
- Overall Floor on I/D total – Applies to wealthy taxpayers.

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Standard Deductions

- Single = $6,350.
- Head of Household = $9,350.
- Married Filing Separately = $6,350.
- Married Filing Jointly = $12,700.
- If elderly or blind, add $1,250 to the Standard Deduction ($2,500 if both elderly AND blind).
- Married couples can increase their standard deduction a maximum of $5,000.

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Disallowance of Standard Deduction

- Return < 12 months due to change in acct'g period
- Married filing separately where spouse itemizes
- Nonresident Alien

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Personal Exemptions ("P/E")

- P/E = $4,050 per taxpayer.
- Married filing jointly claims two exemptions (one for each spouse).
- May also claim P/E for each dependent.
- If taxpayer is being claimed as a dependent of another, he/she cannot claim him-/herself on own tax return.

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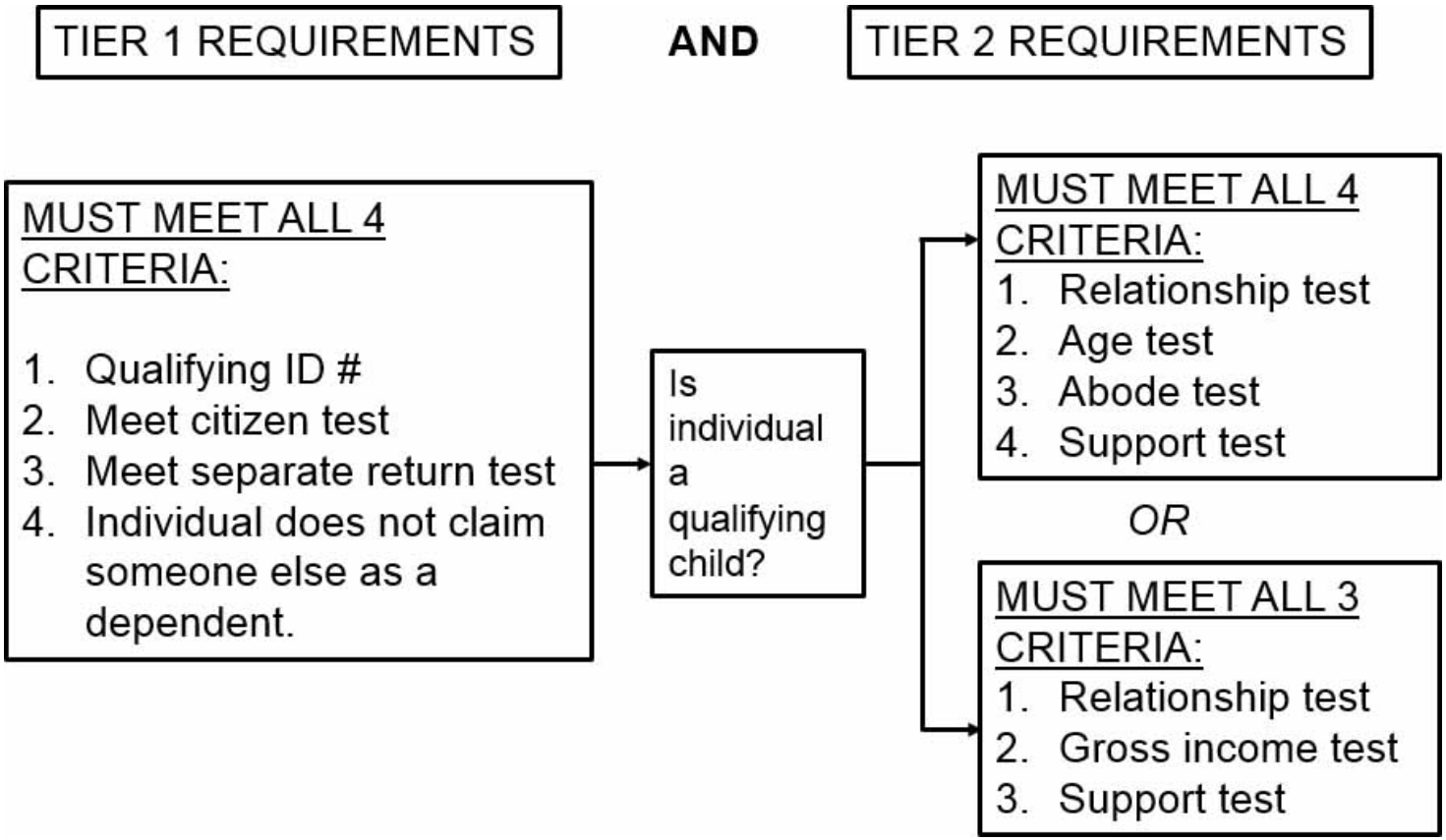
Dependency Exemptions – Qualification



Note: Individual must meet both Tier 1 and Tier 2 criteria to qualify as the taxpayer's dependent.

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Tier 1 Criteria for Dependency Exemption

- ID # – Each dependent must have a SSN.
- Citizenship – Must be US citizen, US national, or legal resident.
- Separate return test:
  - Generally, dependent cannot file joint return with spouse.
  - Exception: dependent files joint return only to obtain refund of tax withheld.

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Tier 2 Criteria – Dependent is a Qualifying Child (1 of 3)

- Relationship Test – Eligible individuals:
  - Taxpayer's natural, adopted, foster, and step-children.
  - Taxpayer's siblings, half-siblings, and step-siblings.
  - Any descendants of the above.
  - Adoption = legal adoptions or child being legally placed in home for adoption.

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Tier 2 Criteria – Dependent is a Qualifying Child (2 of 3)

- Age Test – Must fall within at least one category:
  - Under age 19; OR
  - Permanently and totally disabled (any age); OR
  - Full-time student under age 24.
    - Considered full-time student if dependent is enrolled at qualifying institution for at least 5 months and carries a full course load.

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Tier 2 Criteria – Dependent is a Qualifying Child (3 of 3)

- Abode Test – Must have same principal abode as the taxpayer for > ½ the year.
  - Non-custodial parent meets Abode test if custodial parent agrees in writing.
- Support Test – Dependent can't provide more than ½ of his/her support.

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Tier 2 Criteria – Other Qualifying Individuals (1 of 2)

- Relationship Test – Must fall within at least one category:
  - **Related to the taxpayer.**
    - Does not have to live with taxpayer.
    - Can be a qualifying child, parents (including parents' ancestors and siblings), step-parents, or certain in-laws.
    - Taxpayer's cousins do not qualify under this category.
  - **Resides in taxpayer's home the entire year.**
  - Dependent needs only to be related to one spouse in a joint return. Relationship is not terminated by death or divorce once established.

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Tier 2 Criteria – Other Qualifying Individuals (2 of 2)

- Gross Income Test – Dependent's taxable gross income must be < exemption amount for the year ($4,050 in 2017).
- Support Test – Taxpayer must provide more than ½ of dependent's financial support.
  - Include non-taxable amounts spent except scholarships.
  - Include FMV of items in support calculation including imputed rent.
  - Do not include FMV of personal services rendered by taxpayer to dependent.

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Tie-Breaker Rules for Dependency Exemption

- If more than one taxpayer can potentially claim an individual as a dependent, then the possible claimants are prioritized in order of greatest claim to least:
  1. TP who can claim under qualifying child rules vs. other relatives.
  2. Parents have greater claim over non-parents.
  3. If 1. and 2. don't apply, then exemption goes to TP with highest AGI.

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Multiple Support Agreements (1 of 2)

- If group provides > 50% support but no one person provides > 50%, then the eligible members can designate one person.
- Eligible members must agree in writing.
- Claimant must complete a Multiple Support Declaration (Form 2120).
- MSD trumps tie-breaker rules.
- TP who can claim under qualifying child rules can't transfer to another TP who can claim under the dependent's rules.

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Multiple Support Agreements (2 of 2)

Form **2120**
(Rev. October 2005)
Department of the Treasury
Internal Revenue Service

Multiple Support Declaration

▶ **Attach to Form 1040 or Form 1040A.**

OMB No. 1545-0074

Attachment Sequence No. **114**

Name(s) shown on return: Gabe I. Abel

Your social security number: 123 : 45 : 6789

During the calendar year 2016, the eligible persons listed below each paid over 10% of the support of:

John T. Abel
Name of your qualifying relative

I have a signed statement from each eligible person waiving his or her right to claim this person as a dependent for any tax year that began in the above calendar year.

Mable B. Abel — Eligible person's name
222 : 11 : 0001 — Social security number
402 N. Lable Lane, Lawrence, NJ 08649 — Address (number, street, apt. no., city, state, and ZIP code)

Eligible person's name — Social security number
Address (number, street, apt. no., city, state, and ZIP code)

Eligible person's name — Social security number
Address (number, street, apt. no., city, state, and ZIP code)

Eligible person's name — Social security number
Address (number, street, apt. no., city, state, and ZIP code)

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Parental Release

- Generally, exemption is awarded to custodial parent.
- Exception – Non custodial parent can claim exemption if other parent signs Form 8332.

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Refundable Tax Credits

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Nonrefundable Credits

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Child Credits – § 24

- Can claim $1,000 credit for each qualifying child. Partially refundable.
- Qualifying child = same definition as for dependency exemption except < 17 years.
- Credit is reduced $50 for every $1,000 (or part thereof) over the following thresholds:
- MFS - $55,000
- Single - $75,000
- MFJ - $110,000

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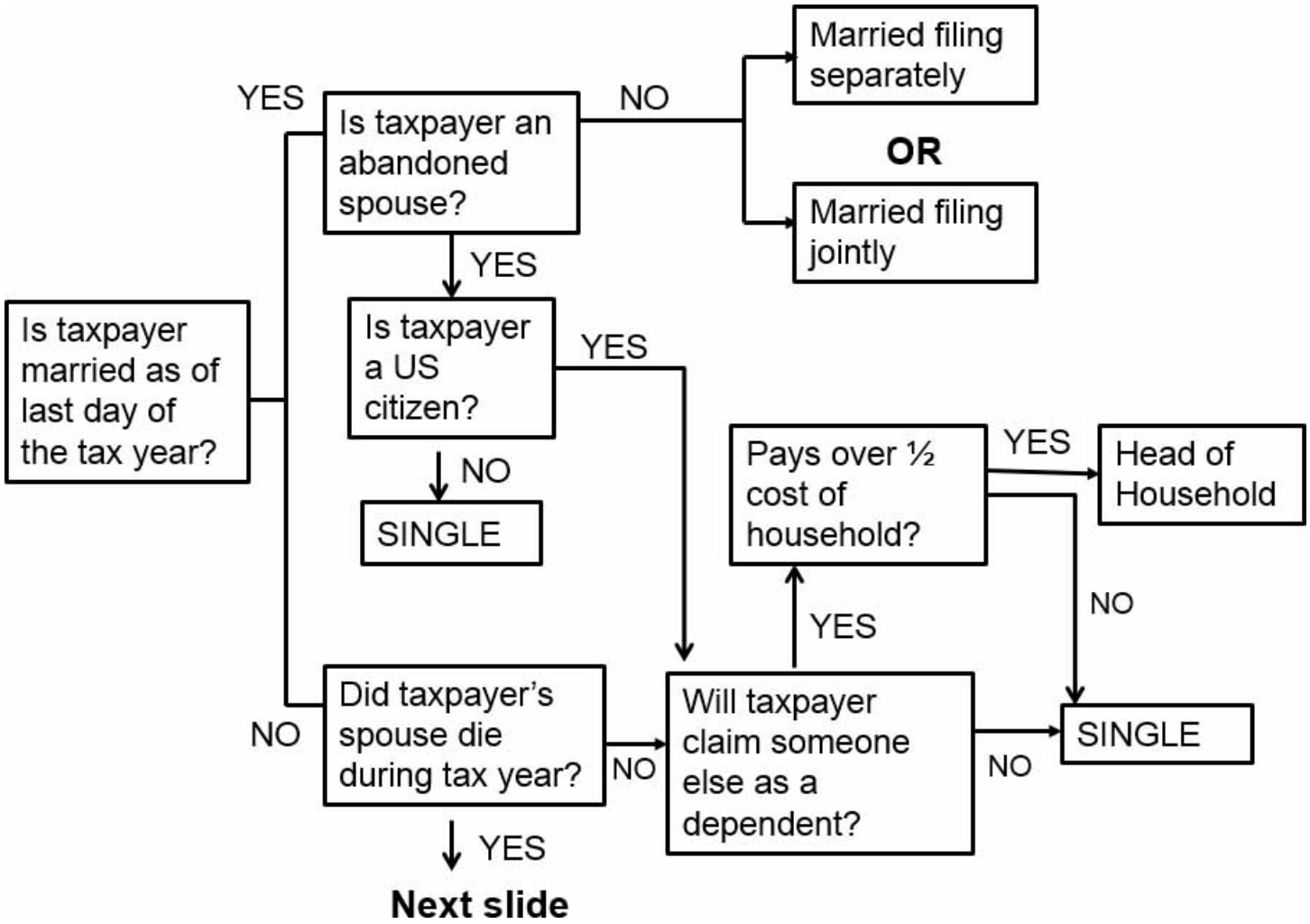
Determining Filing Status (1 of 2)



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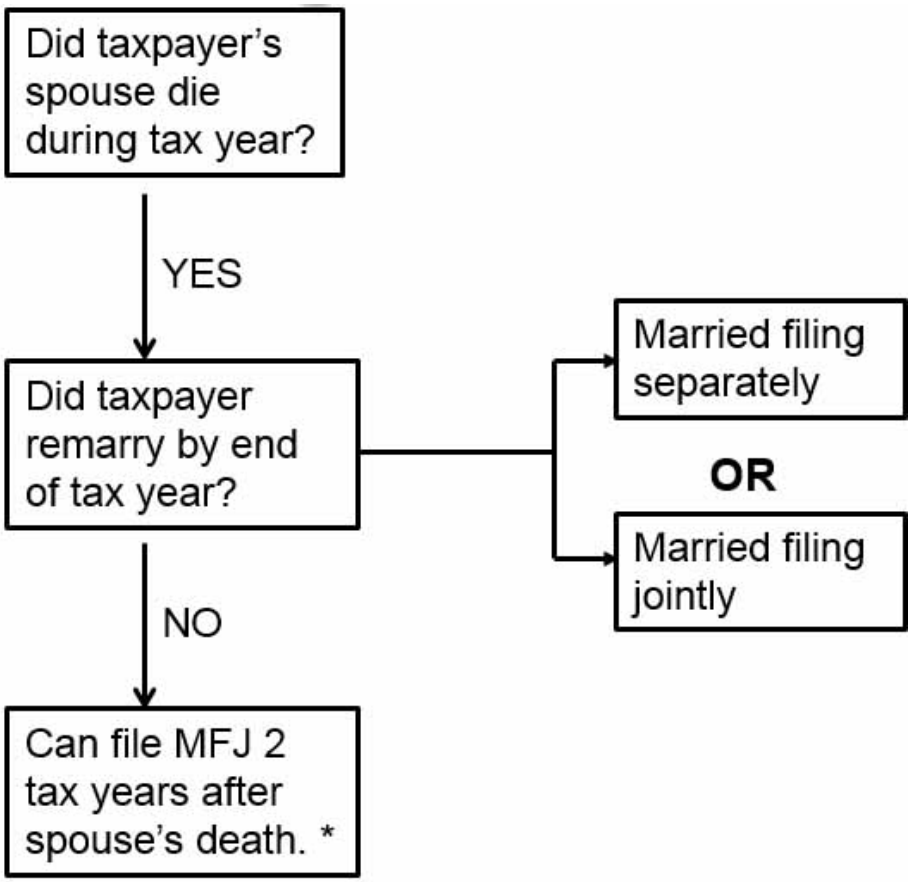
Determining Filing Status (2 of 2)



*** Additional requirements apply in Year 2.**

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Surviving Spouse Criteria

Year 1

- If not remarried, can claim MFJ.
- Can claim exemption for self and deceased spouse.
- Can use MFJ tax schedule and MFJ standard deduction.

Year 2

- Cannot be remarried by end of Year 2.
- Must be a US citizen or resident.
- Must have a dependent living at home with TP paying over ½ expenses of home.
- Can't claim exemption for deceased spouse.

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Children with Unearned Income (1 of 2)

- Children with earned or unearned income are required to file own tax return if otherwise over filing threshold.
- Dependents do not claim a personal exemption.
- Standard deduction is limited to <u>greater of</u>:
  - $1,050; OR
  - Dependent's earned income + $350.

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Children with Unearned Income (2 of 2)

- "Kiddie Tax" – If child is under 18 (24 in some cases), child's unearned income is taxed at parent's marginal rate.
- < 18, "kiddie tax" applies to UI > $2,100.
- 19 ≤ child's age ≤ 23, "kiddie tax" if:
  1. Full-time student; AND
  2. Earned income ≤ 1/2 support; AND
  3. UI > $2,100.
- @18, "kiddie tax" if:
  1. Earned income ≤ 1/2 support; AND
  2. UI > $2,100.

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Treatment of Capital Gains/Losses (1 of 2)

- Capital gains (“C/G”) and capital losses (“C/L”) derive from sale or exchange of capital assets.
- Net long-term capital gains are taxed at a lower rate than Ordinary Income (“OI”).
- Net short-term capital gains are taxed as OI.

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Treatment of Capital Gains/Losses (2 of 2)

- Capital assets are general trade, business, or investment property that are not inventory.
- Net C/L are deductible only up to $3,000. Excess C/L can be carried forward.

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Maximum Net Capital Gain Rates

Taxpayer Bracket	Max C/G Rates
10%, 15%	0%
25%–35%	15%
39.6%	20%*

*3.8% surtax applies to high-income taxpayer on investment income, net C/G, interest.

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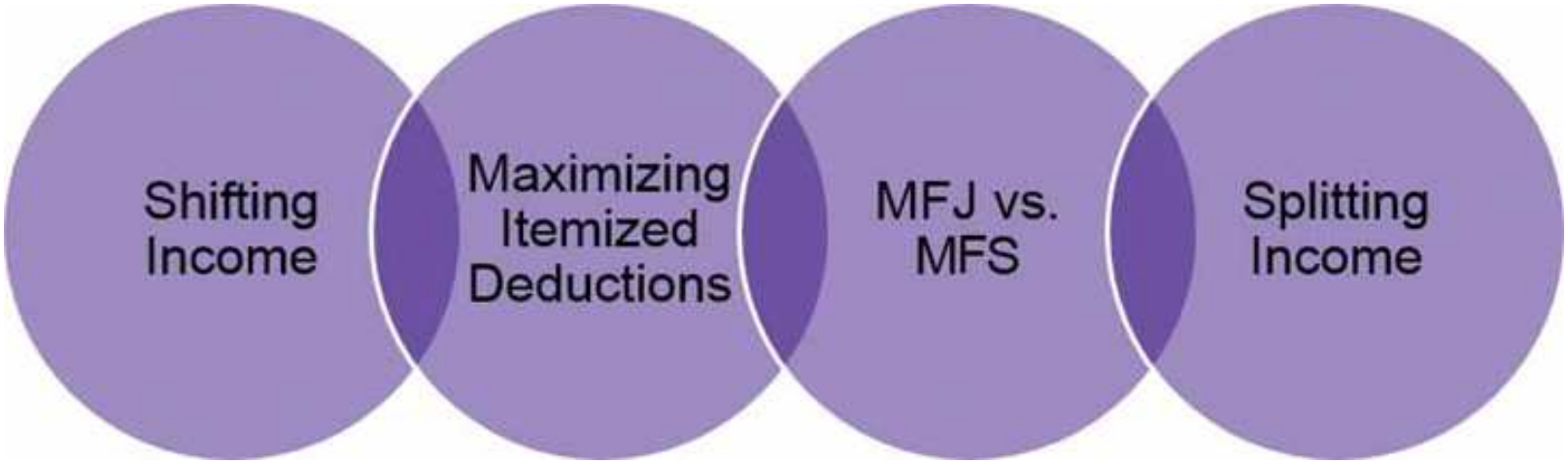
Tax Planning Considerations



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Who Must File? (1 of 2)

For taxpayers under 65, must file if gross income exceeds following levels even if no tax due (2017 thresholds):

Single	$10,400
MFJ	$20,800
Surviving Spouse	$16,750
MFS	$ 4,050
Married living separately	$ 4,050
Head of Household	$13,400

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Who Must File? (2 of 2)

Taxpayer must still file even if gross income below threshold if:

1. Taxpayer rec'd advance payments of EIC.
2. Taxpayer has S-E income > $400.
3. Taxpayer who is claimed as a dependent by another AND unearned income > $1,050 or GI > Std. deduction.

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Due Dates

- Individuals – April 15
- C Corporations – 15th day of the 4th month after close of tax year.
- Partnership and S Corporations – 15th day of the 3rd month after close of tax year.
- If due date falls on weekend or national holiday, due date is moved to the first business day following.
- Extensions – 6 months for Individuals, Partnership, and S Corporations. 5, 6, and 7 months for Corporations.

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Types of Individual Returns

- 1040
- 1040EZ
- 1040A

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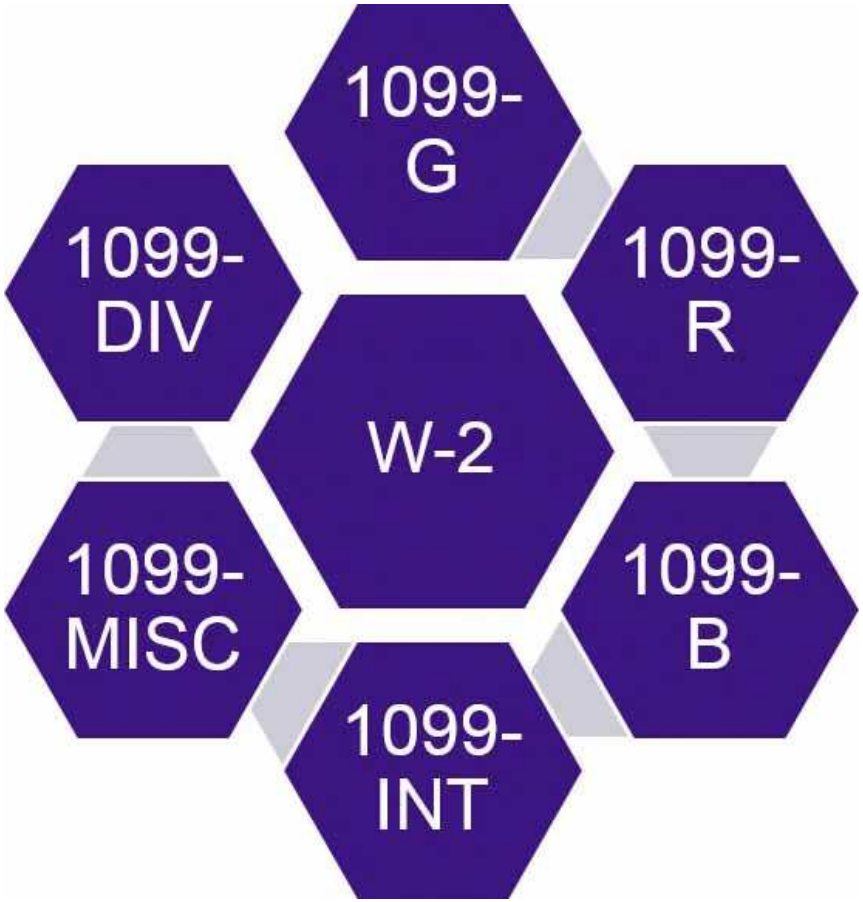
Reports Filed with IRS



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