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TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

1) The profit motive distinguishes "business" activities from "personal" activities.
Answer: ✓ True False

2) All business expense deductions are claimed as "above the line" deductions.
Answer: True ✓ False

3) All investment expenses are itemized deductions.
Answer: True ✓ False

4) Rental or royalty expenses are deductible "for" AGI.
Answer: ✓ True False

5) To be deductible, business expenses must be directly related to a business activity.
Answer: ✓ True False

6) The phrase "ordinary and necessary" means that an expense must be appropriate and helpful for generating a profit.
Answer: ✓ True False

7) All reasonable moving expenses are deductible if the move is a minimum of 35 miles in distance from the taxpayer's old residence to the taxpayer's new residence.
Answer: True ✓ False

8) To deduct a moving expense, the taxpayer must be employed or self-employed for a specific amount of time after the move.
Answer: ✓ True False

9) Self-employed taxpayers can deduct the cost of health insurance as long as they do not actually participate in their spouses' employer-provided health plan.
Answer: True ✓ False

10) Self-employed taxpayers can choose between claiming a deduction or a credit for the employer portion of self-employment taxes paid.
Answer: True ✓ False

11) An individual who forfeits a penalty for prematurely withdrawing a certificate of deposit (CD) is allowed to net the penalty against the interest income from the CD.
Answer: True ✓ False

12) Qualified education expenses for purposes of the deduction of interest on educational loans are expenses paid for the education of the taxpayer, the taxpayer's spouse, or a taxpayer's dependent to attend a post-secondary institution of higher education.
Answer: ✓ True False

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13) The definition of qualifying expenses is more restrictive for the qualified educational expense deduction than it is for the education loan interest expense deduction.

Answer: ✓ True False

14) The medical expense deduction is designed to provide relief for doctors and medical practitioners.

Answer: True ✓ False

15) Deductible medical expenses include payments to medical care *providers* such as doctors, dentists, and nurses and medical care *facilities* such as hospitals.

Answer: ✓ True False

16) Taxpayers traveling for the primary purpose of receiving essential and deductible medical care may deduct the cost of travel.

Answer: ✓ True False

17) The deduction for medical expenses is limited to the amount of unreimbursed qualifying medical expenses paid during the year *reduced* by two percent of the taxpayer's AGI.

Answer: True ✓ False

18) The itemized deduction for taxes includes all types of state, local, and foreign taxes.

Answer: True ✓ False

19) Taxpayers may elect to deduct state and local sales taxes *instead of* deducting state and local income taxes.

Answer: ✓ True False

20) Taxpayers are allowed to deduct mortgage interest on up to $1,000,000 of acquisition debt for their qualified residence and on up to $500,000 of home-equity debt.

Answer: True ✓ False

21) The deduction for investment interest in excess of the net investment income carries forward to the subsequent year.

Answer: ✓ True False

22) To qualify as a charitable deduction the donation must be made by cash or by check.

Answer: True ✓ False

23) In general, taxpayers are allowed to deduct the fair market value of long-term capital gain property on the date of the donation to a qualified charitable organization.

Answer: ✓ True False

24) The deduction to individual taxpayers for charitable contributions paid in cash made to public charities is limited to ten percent of the taxpayer's AGI whereas casualty losses on personal assets are only deductible to the extent the losses exceed ten percent of the taxpayer's AGI.

Answer: True ✓ False

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25) Unreimbursed employee business expenses, investment expenses, hobby expenses, and certain other expenses are classified as miscellaneous itemized deductions and are deductible only to the extent that their sum exceeds 2% of the taxpayer's AGI.

Answer: ✓ True False

26) Taxpayers are allowed to deduct all ordinary and necessary expenses incurred in connection with determining their tax obligations imposed by federal authorities.

Answer: ✓ True False

27) Bunching itemized deductions is one form of tax evasion.

Answer: True ✓ False

28) Taxpayers generally deduct the lesser of their standard deduction or their itemized deductions.

Answer: True ✓ False

29) Taxpayers filing single and taxpayers filing married separate have the same basic standard deduction amount.

Answer: ✓ True False

30) An individual who is eligible to be claimed as a dependent on another's return and has $1,000 of earned income may claim a standard deduction of $1,350.

Answer: ✓ True False

31) In 2017, personal and dependency exemptions are $6,350 for single taxpayers.

Answer: True ✓ False

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

32) Congress allows self-employed taxpayers to deduct the cost of health insurance above the line (for AGI) because:

A) health insurance premiums cannot be deducted otherwise.
B) self-employed taxpayers need an alternate mechanism for reducing the cost of health care.
C) this deduction provides a measure of equity between employees and the self-employed.
D) employers are allowed to deduct social security (FICA) taxes as a business expense.
E) None of the choices are correct.

Answer: C

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33) Which of the following is a true statement?
A) Congress allows self-employed taxpayers to deduct the employer portion of their self-employment tax.
B) Business activities never require a relatively high level of involvement or effort from the taxpayer.
C) To deduct expenses associated with any profit motivated activity, taxpayers must maintain a high level of involvement or effort in the activity throughout the year.
D) All business expenses are deducted for AGI.
E) All of the choices are true.

Answer: A

34) Which of the following is a true statement?
A) Unreimbursed employee business expenses are deductible as miscellaneous itemized deductions.
B) Business deductions are one of the most common deductions for AGI but they are not readily visible on the front of Form 1040.
C) The distinction between business and investment expenses is critical for determining whether a deduction is claimed above the line (for AGI) or below the line (itemized).
D) With one exception, investment expenses are deductible as itemized deductions.
E) All of the choices are true.

Answer: E

35) Which of the following is a true statement?
A) Tax preparation fees are deducted for AGI.
B) All business expenses are deducted for AGI.
C) Rental and royalty expenses are deducted for AGI.
D) Investment expenses are typically deducted for AGI.
E) All of the choices are true.

Answer: C

36) Which of the following is a true statement?
A) The moving expense deduction is restricted to expenses associated with moving personal possessions to the new residence.
B) To satisfy the business test, the taxpayer must be employed full-time for 45 of the first 52 weeks after the move.
C) To satisfy the distance test, the distance from the taxpayer's old residence to the new place of work must be at least 50 miles more than the distance from the old residence to the old place of work.
D) Individuals qualify for the moving expense deduction only if they change employers.
E) All of the choices are true.

Answer: C

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37) Which of the following is a true statement?
A) The deduction for interest on educational loans is subject to a phase-out limitation.
B) Taxpayers are not allowed to receive a moving allowance from their employers.
C) Self-employed taxpayers are allowed to deduct health care premiums even if the taxpayer is eligible to participate in an employer-provided health plan.
D) The deduction for moving expenses is subject to a phase-out limitation.
E) All of the choices are false.

Answer: A

38) Which of the following is a true statement?
A) Self-employment taxes paid by self-employed taxpayers are deductible as business expenses.
B) Self-employed taxpayers are *not* allowed to deduct health care premiums if the taxpayer is *eligible* to participate in their spouse's employer-provided health plan.
C) The maximum deduction for educational interest is $5,000 for married taxpayers filing jointly.
D) For purposes of the deduction for educational interest, an educational loan must be used to pay tuition to any type of school.
E) All of the choices are true.

Answer: B

39) Which of the following is a true statement?
A) For purposes of the deduction for educational interest, qualified education expenses are those paid for the education of the taxpayer, the taxpayer's spouse, or a taxpayer's dependent.
B) A penalty paid for prematurely withdrawing a certificate of deposit or similar deposit is deductible as an investment expense.
C) For purposes of the deduction for educational interest, expenses do not include expenses for room, board and travel.
D) The maximum deduction for interest expense on qualified education loans is $6,000.
E) All of the choices are false.

Answer: A

40) This year, Jong paid $3,000 of interest on a qualified education loan. Jong files married filing joint and reports modified AGI of $147,000. What is Jong's deduction for interest expense on an educational loan?
A) $1,500.
B) $3,000.
C) $1,000.
D) $2,500.
E) None of the choices are correct.

Answer: A

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41) Mason paid $4,100 of interest on a loan that paid tuition for him to attend a private university this year. How much of this payment can Mason deduct as interest expense on an educational loan if he files single and reports modified AGI of $90,000?
A) $4,100.
B) $2,667.
C) $2,000.
D) $4,000.
E) None of the choices are correct.
Answer: E

42) This year Riley files single and reports modified AGI of $71,000. Riley paid $1,200 of interest on a qualified education loan. What amounts can Riley deduct for qualifying education interest?
A) The deduction for qualifying education interest is $1,000.
B) The deduction for qualifying education interest is $200.
C) The deduction for qualifying education interest is $1,200.
D) The deduction for qualifying education interest is $720.
E) None of the choices are correct.
Answer: D

43) Max paid $5,000 of tuition for him to attend a private university this year. How much of this payment can Max deduct as a qualifying education expense if he files single and reports modified AGI of $60,000 (assume the 2016 rules apply for purposes of the qualified education expense deduction)?
A) $0.
B) $4,000.
C) $2,000.
D) $5,000.
E) None of the choices are correct.
Answer: B

44) Han is a self-employed carpenter and his wife, Christine, works full-time as a grade school teacher. Han paid $525 for carpentry tools and supplies, and Christine paid $3,600 as her share of health insurance premiums (not with pre-tax dollars) for Han and herself in a qualified plan provided by the school district (not through an exchange). Which of the following is a true statement?
A) Both expenditures are itemized deductions.
B) The tools and supplies are an itemized deduction but the health insurance is deductible for AGI.
C) The tools and supplies are deductible for AGI while the health insurance is an itemized deduction.
D) Both expenditures are deductible for AGI.
E) Neither of the expenditures is deductible.
Answer: C

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45) Bruce is employed as an executive and his wife, Marie, is a self-employed realtor. Besides Bruce's salary, Bruce and Marie own a warehouse that they rent to a local business for storage. This year they paid $1,250 for electric service in the warehouse. Marie also paid self-employment tax of $6,200 and Bruce had $7,000 of Social Security taxes withheld from his pay. Marie paid $45 fee to rent a safe deposit box to store records associated with her realty operation. Which of the following is a true statement?

A) The safe deposit fee and the electric bill are deductible for AGI.
B) One-half of the social security tax is deductible for AGI.
C) Only the electric bill is deductible for AGI.
D) The self-employment tax is not deductible.
E) None of the choices are true.

Answer: A

46) Casey currently commutes 35 miles to work in the city. He is considering a new assignment in the suburbs on the other side of the city that would increase his commute considerably. He would like to accept the assignment, but he thinks it might require that he move to the other side of the city. Which of the following is a true statement?

A) Casey can deduct moving expenses if the distance between his current residence and his new assignment is at least 50 miles.
B) If Casey's move qualifies for the moving expense deduction, he can deduct the cost of meals while en route to his new residence.
C) If Casey's move qualifies for the moving expense deduction, he can deduct half the cost of meals while en route to his new residence.
D) To qualify for a moving expense deduction the new commute from Casey's current residence would need to be a minimum of 85 miles.
E) All of the choices are false.

Answer: D

47) Jill currently lives in the suburbs and commutes 25 miles to her office in downtown Freeport. She is considering quitting her current job to look for new employment in the downtown area. Which of the following statements best describes how Jill can satisfy the distance test for deducting moving expenses if she accepts a new job in downtown Freeport?

A) Jill must move 25 miles east from downtown Freeport.
B) Jill must move 50 miles further away from downtown Freeport.
C) Jill must move at least 25 miles further away from downtown Freeport.
D) Jill need not move her residence because she is starting a new job.
E) Jill cannot satisfy the distance test if she accepts a job in downtown Freeport.

Answer: E

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48) Which of the following expenses can be deducted as moving expenses?

- The cost of a trip to purchase a new residence
- The cost of moving personal belongings
- Lodging (one night) while en route
- The cost of gasoline when traveling to the new residence
- One-half of the cost of meals while en route to the new residence

A) Numbers 2 through 5 only.
B) Numbers 2 through 4 only.
C) Numbers 1, 2, and 4 only.
D) Numbers 1 through 3 only.
E) All the numbers are deductible as moving expenses.

Answer: B

49) Brice is a single, self-employed electrician who earns $60,000 per year in self-employment income. E paid the following expenses this year. Which of the expenses are deductible for AGI?

- The cost of health insurance (not purchased through an exchange)
- The employer portion of self-employment tax paid
- Penalty on early withdrawal of funds from a certificate of deposit

A) Numbers 2 and 3 only.
B) Numbers 1 and 3 only.
C) Numbers 1 and 2 only.
D) None of the numbers are deductible for AGI.
E) All the numbers are deductible for AGI.

Answer: E

50) Hector is a married self-employed taxpayer, and this year he paid $3,000 for his health insurance premiums (not through an exchange). Under which of the following alternative conditions can Hector deduct the cost of the premiums for AGI?

A) Neither Hector nor his spouse participates in an employer-sponsored plan although both are eligible to participate in a plan.
B) Hector chose not to participate in the employer-sponsored plan of his spouse.
C) Hector can deduct the health insurance premiums regardless of the insurance status of his spouse.
D) Hector's spouse participates in an employer-sponsored plan but Hector is not eligible to participate in this plan.
E) None of the choices - health insurance premiums can only be deducted as an itemized deduction.

Answer: D

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51) Lewis is an unmarried law student at State University, a qualified educational institution. Last year Lewis borrowed $30,000 and used the proceeds to pay his university tuition. This year Lewis paid $1,500 of interest on the loan. Which of the following is a true statement if Lewis reports $40,000 of salary and no other items of income or expense?

A) Lewis can only deduct $1,000 of the interest on his student loan as an itemized deduction.
B) Lewis can deduct all the interest on his student loan for AGI.
C) Lewis can deduct all the interest on his student loan as an itemized deduction.
D) Lewis can only deduct $1,000 of the interest on his student loan for AGI.
E) All of the choices are false.

Answer: B

52) Grace is a single medical student at State University, a qualified educational institution. This year Grace paid university tuition of $12,000. Grace works part-time at the University library, and this year she reports $15,000 of salary and no other items of income or expense. Which of the following is a true statement?

A) Grace can deduct all of her tuition for AGI as a business expense.
B) Grace can only deduct half of her tuition as a miscellaneous itemized deduction.
C) Grace can deduct all of her tuition as a miscellaneous itemized deduction.
D) Grace can only deduct half of her tuition for AGI as a business expense.
E) All of the choices are false.

Answer: E

53) This fall Manfred enrolled in the law school at State University (a qualified educational institution) and paid $6,200 in tuition. Until his enrollment Manfred worked as a stock broker and this year he reports $70,000 in wages. If Manfred files single and reports no other items of income or expense how much of the tuition can he deduct as a business expense?

A) Manfred can deduct half of his tuition as a miscellaneous itemized deduction.
B) Manfred can deduct $6,200 as a miscellaneous itemized deduction.
C) Manfred can deduct half of his tuition for AGI.
D) Manfred can deduct $6,200 for AGI.
E) None - the tuition is not deductible as a business expense.

Answer: E

54) This fall Millie finally repaid her student loan. She originally borrowed the money to pay tuition several years ago when she attended at State University (a qualified educational institution). This year Millie paid a total of $2,400 of interest on the loan. If Millie files single and reports $70,000 of income and no other items of income or expense how much of the interest can she deduct?

A) Millie can deduct $1,600 for AGI.
B) Millie can deduct $800 for AGI.
C) Millie can deduct $2,400 for AGI.
D) Millie can deduct $2,400 as an itemized deduction.
E) None - the tuition is not deductible.

Answer: A

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55) This fall Marsha and Jeff paid $5,000 for their son Josh's tuition and fees at State University (a qualified education institution). They also paid $1,000 for Josh's books. How much of these two payments can Marsha and Jeff deduct this year, assuming Josh is their dependent and their modified AGI is $135,000? (Assume the 2016 rules apply for purposes of the qualified education expense deduction.)

A) Marsha and Jeff can deduct $2,500 for AGI.
B) Marsha and Jeff can deduct $2,000 for AGI.
C) Marsha and Jeff can deduct $5,000 for AGI.
D) Marsha and Jeff can deduct $4,000 for AGI.
E) None - the tuition is not deductible.

Answer: B

56) This fall, Josh paid $5,000 for his tuition and fees at State University (a qualified education institution). Assume that Josh is Marsha and Jeff's son and that Marsha and Jeff claim Josh as a dependent. Marsha and Jeff's modified AGI is $100,000. How much of Josh's $5,000 tuition and fees payments can Marsha and Jeff deduct this year? (Assume the 2016 rules apply for purposes of the qualified education expense deduction.)

A) Marsha and Jeff can deduct $2,500 for AGI.
B) Marsha and Jeff can deduct $5,000 for AGI.
C) Marsha and Jeff can deduct $2,000 for AGI.
D) Marsha and Jeff can deduct $4,000 for AGI.
E) None - the tuition is not deductible by Marsha and Jeff.

Answer: E

57) Ned is a head of household with a dependent son, Todd, who is a full-time student. This year Ned ma following expenditures related to Todd's support:

Auto insurance premiums	$1,700
Room and board at Todd's school	2,200
Health insurance premiums (not through an exchange)	600
Travel (to and from school)	350

What amount can Ned include in his itemized deductions?

A) $600 included in Ned's medical expenses.
B) $1,700 included in Ned's miscellaneous itemized deductions.
C) $2,050 included in Ned's miscellaneous itemized deductions.
D) $950 included in Ned's miscellaneous itemized deductions.
E) None of the choices are correct.

Answer: A

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58) Which of the following is a true statement?
A) A divorced taxpayer can deduct medical expenses incurred for a child even if the child is claimed as a dependent by the former spouse.
B) A taxpayer can deduct medical expenses incurred for members of his family who are dependents.
C) A taxpayer can deduct medical expenses incurred for a qualified relative even if the relative does not meet the gross income test.
D) Deductible medical expenses include long-term care services for disabled spouses and dependents.
E) All of the choices are true.
Answer: E

59) Which of the following costs are deductible as an itemized medical expense?
A) The cost of elective cosmetic surgery.
B) Medical expenses reimbursed by health insurance.
C) Medical expenses incurred to prevent disease.
D) The cost of prescription medicine and over-the-counter drugs.
E) None of the costs are deductible.
Answer: C

60) Which of the following costs are NOT deductible as an itemized medical expense?
A) Payments to a hospital.
B) Transportation for medical purposes.
C) The cost of insurance for long-term care services.
D) The cost of eyeglasses.
E) All of the choices are deductible as medical expenses.
Answer: E

61) Opal fell on the ice and injured her hip this winter. As a result she paid $3,000 for a visit to the hospital emergency room and $750 for follow-up visits with her doctor. While she recuperated, Opal paid $500 for prescription medicine and $600 to a therapist for rehabilitation. Insurance reimbursed Opal $1,200 for these expenses. What is the amount of Opal's qualifying medical expense?
A) $4,850.
B) $3,650.
C) $3,750.
D) $3,000.
E) All of the choices are correct.
Answer: B

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62) Which of the following taxes will <u>not</u> qualify as an itemized deduction?
A) gasoline taxes on personal travel.
B) state, local, and foreign income taxes.
C) real estate taxes on a residence.
D) personal property taxes assessed on the value of specific property.
E) None of the choices qualify as an itemized deduction.
Answer: A

63) This year Amanda paid $749 in Federal gift taxes on a gratuitous transfer to her nephew. Amanda lives in Texas and does not pay any state or local income taxes. Which of the following is a true statement?
A) Amanda cannot deduct Federal gift taxes.
B) Amanda can deduct Federal gift taxes for AGI.
C) Amanda must include Federal gift taxes with other miscellaneous itemized deductions.
D) Amanda can deduct Federal gift taxes paid as an itemized deduction.
E) None of the choices are true.
Answer: A

64) This year Norma paid $1,200 of real estate taxes on her personal residence. Norma's other itemized deductions (state income taxes) only amount to $3,100. Which of the following is a true statement if Norma files single with one personal exemption?
A) Norma can deduct 4,300 for AGI.
B) Norma should deduct $4,300 even if her standard deduction is $6,350.
C) Norma should deduct $3,100 even if her standard deduction is $6,350.
D) Norma should deduct $1,200 even if her standard deduction is $6,350.
E) Norma should claim the standard deduction.
Answer: E

65) Madeoff donated stock (capital gain property) to a public charity. He purchased the stock 3 years ago for $100,000, and on the date of the gift, it had a fair market value of $200,000. What is his maximum charitable contribution deduction for the year related to this stock if his AGI is $500,000 (before considering the itemized deduction phase-out)?
A) $250,000.
B) $150,000.
C) $100,000.
D) $200,000.
E) None of the choices are correct.
Answer: B

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66) Carly donated inventory (ordinary income property) to a church. She purchased the inventory last month for $100,000, and on the date of the gift, it had a fair market value of $92,000. What is her maximum charitable contribution deduction for the year related to this inventory if her AGI is $200,000?

A) $60,000.
B) $46,000 if the church sells the inventory.
C) $92,000.
D) $100,000.
E) None of the choices are correct.

Answer: C

67) Simone donated a landscape painting (tangible capital gain property) to a library, a public charity. She purchased the painting five years ago for $50,000, and on the date of the gift, it had a fair market value of $200,000. What is her maximum charitable contribution deduction for the year if her AGI is $300,000 (before considering the itemized deduction phase-out)?

A) $150,000.
B) $200,000.
C) $100,000.
D) $90,000 if the library uses the painting in its charitable purpose.
E) None of the choices are correct.

Answer: D

68) Larry recorded the following donations this year:

$500 cash to a family in need
$2,400 to a church
$500 cash to a political campaign
To the Salvation Army household items that originally cost $1,200 but are worth $300.

What is Larry's maximum allowable charitable contribution if his AGI is $60,000?

A) $1,000.
B) $4,600.
C) $2,700.
D) $2,900.
E) None of the choices are correct.

Answer: C

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69) Which of the following is a true statement?
A) the deduction of capital gain property to public charities is limited to 20 percent of AGI.
B) the deduction of cash contributions to private nonoperating foundations is limited to 30 percent of AGI.
C) the deduction of cash contributions to public charities is limited to 30 percent of AGI.
D) the deduction of capital gain property to private nonoperating foundations is limited to 50 percent of AGI.
E) None of the choices are true.

Answer: B

70) When taxpayers donate cash and capital gain property to a public charity, the AGI percentage limitation is applied in the following order:
A) a 50 percent of AGI limitation is applied to the cash donation and a 20 percent of AGI limitation is applied to the fair market value of the capital gain donation.
B) a 30 percent of AGI limitation is applied to the cash donation and a 20 percent of AGI limitation is applied to the fair market value of the capital gain donation.
C) donations to public charities are not subject to AGI limitations.
D) a 50 percent of AGI limitation is applied to the cash donation and the fair market value of the capital gain donation is subject to the lesser of a 30 percent of AGI limitation or a 50 percent of AGI limitation after subtracting the cash contributions.
E) a 30 percent of AGI limitation is applied to the aggregate donation.

Answer: D

71) Which of the following is a true statement?
A) Taxpayers may deduct interest on up to $1,000,000 of home-equity debt.
B) Taxpayers may only deduct interest on up to $1,500,000 of acquisition indebtedness.
C) The deduction for investment interest expense is not subject to limitation.
D) Interest on home-equity debt up to $100,000 is deductible, even if the loan proceeds are used to buy a new car.
E) None of the choices are true.

Answer: D

72) Margaret Lindley paid $15,000 of interest on her $300,000 acquisition debt for her home (fair market value of $500,000), $4,000 of interest on her $30,000 home-equity loan, $1,000 of credit card interest, and $3,000 of margin interest for the purchase of stock. Assume that Margaret Lindley has $10,000 of interest income this year and no investment expenses. How much of the interest expense may she deduct this year?
A) $18,000.
B) $23,000.
C) $22,000.
D) $19,000.
E) None of the choices are correct.

Answer: C

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73) Which of the following is a true statement?
A) Personal casualty losses can only be deducted to the extent that aggregate casualty losses exceed 10 percent of AGI after applying a $100 per incident deduction.
B) Individual casualty losses are only deductible if each individual loss exceeds $5,000.
C) A casualty loss can only occur from storm damage.
D) Uninsured thefts of personal assets are not included with casualty losses.
E) All of the choices are true.

Answer: A

74) Jim was in an auto accident this year. Jim paid $2,450 to repair his personal-use car after the accident and his insurance only reimbursed him $400. Jim bought his car several years ago for $1,500. What is the amount of casualty loss from this accident before Jim applies any casualty loss floor limitations?
A) $1,500.
B) $1,100.
C) $2,450.
D) $2,050.
E) None of the choices are correct.

Answer: B

75) Which of the following is a true statement?
A) Employees can claim business expense deductions for AGI.
B) Employees cannot claim business expense deductions.
C) Employees can claim business expense deductions as miscellaneous itemized deductions not subject to the 2 percent of AGI limitation.
D) Employees can claim business expense deductions as miscellaneous itemized deductions subject to the 2 percent of AGI limitation.
E) None of the choices are true.

Answer: D

76) Which of the following is a true statement?
A) Traveling from a personal residence to a place of business is deductible if reimbursed by an employer.
B) Traveling from a personal residence to a place of business is nondeductible.
C) Traveling from a personal residence to a place of business is a miscellaneous itemized deduction subject to the 2 percent of AGI limitation.
D) Traveling from a personal residence to a place of business is deducted for AGI as a moving expense.
E) The standard mileage rate can be used to calculate the deduction for traveling from a personal residence to a place of business.

Answer: B

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77) Which of the following is a true statement?

A) Fees for investment advice are included in miscellaneous itemized deductions subject to the 2 percent of AGI limitation.

B) Fees for tax preparation are included in miscellaneous itemized deductions subject to the 2 percent of AGI limitation.

C) Unreimbursed employee business expenses are included in miscellaneous itemized deductions subject to the 2 percent of AGI limitation.

D) Reimbursed employee business expenses are included in miscellaneous itemized deductions subject to the 2 percent of AGI limitation unless the employer's reimbursement plan qualifies as an accountable plan.

E) All of the choices are true.

Answer: E

78) Fred's employer dispatched him on a business trip from the Dallas headquarters to New York this yea the trip Fred incurred the following unreimbursed expenses:

Air fare	$1,300
Lodging	750
Meals	600
Cab fare	220

What is the amount of Fred's deduction before the application of any AGI limitations?

A) $1,300.

B) $2,570.

C) $2,050.

D) $2,870.

E) $0 - the expenses cannot be deducted unless Fred is reimbursed.

Answer: B

79) Which of the following is a true statement?

A) The regulations do not provide any guidance for determining whether an activity is profit motivated.

B) Expenses associated with a "hobby" are never deductible.

C) Taxpayers engaged in a "hobby" are always presumed to be motivated by profit.

D) The deductibility of an activity's expenses in excess of revenues depends upon whether the activity is primarily profit-motivated or a hobby as determined by facts and circumstances.

E) All of the choices are true.

Answer: D

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80) Glenn is an accountant who races stock cars as a hobby. This year Glenn was paid a salary of $80,000 from his employer and won $2,000 in various races. What is the effect of the racing activities on Glenn's taxable income if Glenn has also incurred $4,200 of hobby expenses this year? Assume that Glenn itemizes his deductions but has no other miscellaneous itemized deductions.

A) increase in taxable income of $1,640.
B) no change in taxable income.
C) decrease in taxable income of $560.
D) increase in taxable income of $2,000.
E) decrease in taxable income of $2,200.

Answer: A

81) Grace is employed as the manager of a sandwich shop. This year she earned a salary of $45,000 and i the following expenses associated with her employment:

Subscriptions to food publications	$300
Cooking class ("How to make better subs")	250
Transportation between Grace's home and the shop	500

What amount of miscellaneous itemized deductions can Grace claim on Schedule A if these are her c miscellaneous itemized deductions?

A) $550.
B) $1,050.
C) $200 if Grace was reimbursed $50 for her cooking class.
D) $150.
E) None of the choices are correct.

Answer: E

82) Which of the following is a miscellaneous itemized deduction that is not subject to the 2 percent of AGI floor?

A) fees for investment advice.
B) employee business expenses.
C) gambling losses to the extent of gambling winnings.
D) tax preparation fees.
E) All of the choices are subject to the 2 percent of AGI floor limit.

Answer: C

83) Which of the following itemized deductions is not subject to the itemized deduction phase-out?

A) mortgage interest.
B) gambling losses.
C) charitable contributions.
D) state income tax.
E) All of the choices are subject to the itemized deduction phase-out.

Answer: B

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84) Frieda is 67 years old and deaf. If Frieda files as a head of household, what amount of standard deduction can she claim in 2017?

A) $12,700. B) $10,900. C) $9,350. D) $10,400. E) $1,550.

Answer: B

85) Andres and Lakeisha are married and file joint. Andres is 72 years old and in good health. Lakeisha is 62 years old and blind. What amount of standard deduction can Andres and Lakeisha claim in 2017?

A) $15,200.
B) $12,700.
C) $9,350.
D) $11,850.
E) None of the choices are correct.

Answer: A

86) Which of the following is a true statement?

A) Before any applicable phase-out, the deduction for personal and dependency exemptions is $4,050 times the number of exemptions.
B) Bunching itemized deductions is an illegal method of tax avoidance.
C) The standard deduction is increased for taxpayers who are blind or deaf at year-end.
D) A married couple is only entitled to one addition to their standard deduction even if both spouses are both over age 65.
E) All of the choices are true.

Answer: A

87) Which of the following is a true statement?

A) A married filing joint taxpayer with AGI of $500,000 would not be able to deduct personal and dependency exemptions.
B) Personal exemptions, but not dependency exemptions, are subject to phase-out.
C) Itemized deductions, but not exemptions, are subject to phase-out.
D) At most, only 80% of exemptions are subject to phase-out.
E) None of the choices are true.

Answer: A

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ESSAY. Write your answer in the space provided or on a separate sheet of paper.

88) Scott is a self-employed plumber and his wife, Emily, is a full-time employee for the University. Emily has health insurance from a qualified plan provided by the University, but Scott has chosen to purchase his own health insurance rather than participate in Emily's plan. Besides paying $5,400 for his health insurance premiums, Scott also pays the following expenses associated with his plumbing business:

Plumbing tools and supplies	$1,300
Rent on Scott's plumbing shop	6,250
Transportation between Scott's shop and various job sites	500
Plumber's uniform	50
Plumbing truck rental	7,200
Self employment tax (1/2 is employer share)	400

What is the amount of deductions for AGI that Scott can claim this year (2017)?

Answer: $15,500
$15,500 = $1,300 + $6,250 + $500 + $50 + $7,200 + ($400 *.50). All of the expenses are dedu
AGI except for Scott's health insurance and 50 percent of the self-employment tax.

89) Constance currently commutes 25 miles from her house to her existing part time job in the suburbs. Next week she begins a new full time job in another state, and this job location is 100 miles from her existing home. Because of the additional distance Constance is selling her house, and she has rented an apartment that is only 2 miles from her new job. Constance expects to pay the following moving expenses.

Cost of searching for an apartment	$325
Transportation – auto (computed using the mileage rate of 17 cents per mile, rounded)	17
Cost of van to move furniture and possessions	815
Meals while en route	25

Determine if this move qualifies for a moving expense deduction and calculate the amount (if any) of deduction.

Answer: The move qualifies for a deduction of $832.
The move qualifies under the distance test (commute of 25 miles is extended by 75 miles to 10
and the costs associated with transportation and the moving van are deductible for AGI.

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90) Alexandra operates a garage as a sole proprietorship. Alexandra also owns a half interest in a partner operates a gas station. This year Alexandra paid or reported the following expenses related to her gar other property. Determine Alexandra's AGI for 2017.

Revenue from auto repairs	$143,930
Salaries paid to mechanics	72,210
Supplies and tools	18,500
Revenues from gas station partnership (Alexandra's share)	125,000
Expenses from gas station partnership (Alexandra's share)	95,200
Self-employment tax (1/2 is employer's share)	12,702

Answer: $76,669

All of the expenses are deductible, except only 50% of the self-employment tax is deductible (

91) Shelby is working as a paralegal while attending law school at night. This year she has incurred the f expenses associated with school.

Tuition	$22,700
Room and board	9,200
Books	1,600
Transportation to work	350

What amount can Shelby deduct as an employee business expense if her modified AGI this year is $2

Answer: none

The tuition, books, room/board and transportation are not deductible because they will qualify a new trade (lawyer).

92) Last year Henry borrowed $15,000 to help pay for his dependent daughter's college tuition. This year Henry paid $2,800 of interest on the loan. How much, if any, interest can Henry deduct if he files single with AGI of $72,500?

Answer: $1,250

The deduction for student loan interest is reduced for single taxpayers with AGI above $65,000 below $80,000. The deduction is the amount paid up to $2,500, reduced by the phase-out perce percentage is equal to $72,500 less $65,000 divided by $15,000. In this problem, there is a phas percent ($7,500/$15,000) thereby reducing the amount paid up to $2,500 (in this case, $2,500) deduction of $1,250 [$2,500 − ($2,500 × ($7,500/$15,000)) = $1,250].

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93) Collin and Christine are married and file joint. Their dependent son, Trevor, is a full-time college student at a qualified educational institution. This year Collin and Christine borrowed $30,000 to pay for Trevor's tuition ($22,000) and room and board ($8,000). At year end Collin paid $3,200 in interest on the loan. What amounts can Collin and Christine deduct for interest and education expenses if they estimate that their AGI will be $138,000 absent any deductions for AGI? Assume the 2016 rules apply for purposes of the qualified education expense deduction.

Answer: $2,250 for interest and $2,000 for qualified education expenses.

The deduction for student loan interest is reduced for taxpayers with AGI above $135,000 but b $165,000. The deduction is the amount paid up to $2,500, reduced by the phase-out percentage percentage is equal to $138,000 less $135,000 divided by $30,000. This results in a phase out c percent ($3,000/$30,000) thereby reducing the maximum to $2,250 [$2,500 − ($2,500 × ($3,000/$30,000)) = $2,250]. Since Collin and Christine's modified AGI ($138,000 − $2,250 education interest deduction = $135,750) exceeds $130,000 (but not $160,000), they may deduct the $22, expense paid up to the $2,000 maximum deduction.

94) Kaylee is a self-employed investment counselor who also owns a rental property. This year, she colle $85,000 in fees and paid the following expenses:

Health insurance premiums (not through an exchange)	$ 4,200
Life insurance premiums (whole life)	1,900
Books on investing	200
Repairs of the rental property	450
Advertising for investment clients	1,770
State income taxes	4,300
Self employment tax (1/2 is employer share)	11,732

Kaylee files single with one personal exemption. Calculate her adjusted gross income.

Answer: $72,514 = $85,000 − $12,486

The books on investing, advertising for investment clients, repairs for the rental property, 50% employment taxes, and health insurance premiums are deductible for AGI. The whole life insu premiums are not deductible, and the state income taxes are only deductible from AGI.

95) This year Tiffanie files as a single taxpayer. Tiffanie received $62,700 of salary and paid $3,200 of qualified educational interest. This year Tiffanie has also paid deductible moving expenses of $2,200 and received $12,000 of alimony. What is Tiffanie's AGI?

Answer: $71,250 ($62,700 + $12,000 − $2,200 - $1,250 = $71,250)

The alimony and salary are income, and the moving expense and part of the educational interes deductible for AGI. Tiffanie's maximum educational interest deduction (amount paid up to $2, limited to $1,250. The deduction for educational interest ($2,500) is subject to phase-out becau Tiffanie's modified AGI exceeds $65,000. The phase out is calculated by subtracting $65,000 f Tiffanie's modified AGI ($62,700 + $12,000 − $2,200 = $72,500) and dividing by $15,000 as follows: $2,500 * [($72,500 − $65,000)/$15,000] = $1,250. Thus, the amount deductible is $1,250 [$2,500 − $1,250 = $1,250].

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96) Detmer is a successful doctor who earned $204,800 in fees this year, but he also competes in weeken tournaments. Detmer reported the following expenses associated with competing in almost a dozen tournaments:

Transportation to various tournaments	$3,450
Lodging	1,890
Entry fees	920
Golf supplies (balls, tees, etc.)	75

This year Detmer won $5,200 from competing in various golf tournaments. Assuming that Detmer itemizes his deductions and that he did not have any other miscellaneous itemized deductions, what amount of the golfing expenses are deductible after considering all limitations if the tournament golfing is treated as a hobby activity?

Answer: $1,000 = $5,200 − [2% × ($204,800 + $5,200)]

Detmer's hobby expenses of $6,335 are limited to his revenues ($5,200) and further reduced by (2 percent of AGI which is $204,800 + $5,200).

97) Jenna (age 50) files single and reports AGI of $40,000. This year she has incurred the following med expenses:

Dentist charges	$ 90
Physician's fees	2,800
Cosmetic surgery	400
Cost of eyeglasses	250
Hospital charges	1,330
Prescription drugs	240
Over-the-counter drugs	75
Medical insurance premiums (not through an exchange)	1,200

Calculate the amount of medical expenses that will be included with Jenna's other itemized deductio

Answer: $1,910

All expenses are qualified medical expenses except for the cosmetic surgery and over-the-coun drugs. Hence, the medical expense deduction is $5,910 less $4,000 (10 percent*40,000) = $1,9 this amount is included with other itemized deductions.

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98) Chuck has AGI of $70,000 and has made the following payments

State income tax withholding	$1,900
State income tax estimated payments	850
Federal income tax withholding	7,100
Social Security tax withheld from wages	4,800
State excise tax on liquor	400
State inheritance tax	1,200
County real estate tax	790
School district tax on realty	510

Calculate the amount of taxes that Chuck can include with his itemized deductions.

Answer: $4,050 = $1,900 + $850 + $790 + $510
The deductible taxes include county real estate, school district tax on real estate. State income t
paid and withheld are also deductible.

99) Homer is an executive who is paid a salary of $80,000. Homer also paints landscapes as a hobby. Thi
Homer expects to sell paintings for a total of $750 and incur the following expenses associated with l
painting activities:

Travel	$1,480
Paints and canvas	610
Painting classes	230

What is the effect of Homer's hobby on his taxable income? Assume his AGI does not reflect his pai
activities and that he itemizes deductions but has no other miscellaneous itemized deductions.

Answer: Homer's hobby will increase his taxable income by $750.
Homer will not receive any deduction for the hobby expenses, but the hobby income will increa
taxable income. The deduction for hobby expenses ($2,320) is limited to hobby revenues ($75(
further reduced by $1,615 (2 percent of AGI which is $80,000 + $750).

100) This year, Benjamin Hassell paid $20,000 of interest on a mortgage on his home (Benjamin borrowed $600,000 to buy the residence and it is currently worth $1,000,000), $12,000 on a $150,000 home equity loan on his home, and $10,000 of interest on a mortgage on his vacation home (loan of $300,000; home purchased for $400,000). How much interest expense can Benjamin deduct as an itemized deduction?

Answer: $38,000.
Benjamin's acquisition debt on his home and vacation home does not exceed $1,000,000. Thus
deduct the $20,000 mortgage interest on his home and $10,000 of mortgage interest on his vaca
home. Because his home equity debt exceeds $100,000, he can only deduct a portion of the inte
the $150,000 home equity debt (i.e., the portion attributable to $100,000 of debt). Thus, Benjar
can also deduct $8,000 of home equity interest ($12,000 interest expense × ($100,000 home equity debt limit/$150,000 home equity debt amount) = $8,000).

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101) This year Darcy made the following charitable contributions:

Donee	Property	Cost	FMV
State University	IBM stock	$15,000	$10,500
Salvation Army	clothes	2,500	500
State Art Museum	painting	5,000	45,000
City Hospital	cash	8,000	

Determine the maximum amount of charitable deduction for Darcy's contribution of the painting if h $80,000 this year. You may assume that both the stock and painting have been owned for 10 years and that the painting was used by the State Art Museum consistent with museum's charitable purpose.

Answer: The charitable deduction is $21,000 for the painting and $40,000 overall.

All of the contributions are to public charities, and the overall limit is 50 percent of AGI ($40,(cash, stock, and clothes are subject to the 50 percent of AGI limit. The stock and clothes are no to the 30 percent AGI limit because these are ordinary income properties (basis exceeds its valu neither is capital gain property). Thus, $19,000 is the deduction in the first step of the calculation. The painting is long-term tangible personal property apparently related to the purpose of the charity. Hence, the maximum deduction is the lesser of (1) the value up to the 30 percent AGI limit ($24,000) or (2) the remaining amount of deduction to reach the 50 perce ($21,000). Hence, the maximum deduction this year is $40,000 consisting of cash of $8,000, IE of $10,500, clothes of $500, and the painting of $21,000. The remaining value of the painting $ ($45,000 − $21,000) is carried over to next year subject to the 30 percent of AGI limit.

50 percent AGI limit		$ 40,000
50 percent Contributions - cash	8,000	
50 percent Contributions - clothes	500	
50 percent Contributions – stock	+ 10,500	
Total 50 percent contributions		- 19,000
Maximum remaining contribution to reach 50 percent		$ 21,000

102) Claire donated 200 publicly-traded shares of stock (held for 5 years) to her father's nonoperating private foundation this year. The stock was worth $15,000 but Claire's basis was only $4,000. Determine the maximum amount of charitable deduction for the donation if Claire's AGI is $60,000 this year.

Answer: $12,000

The stock is long-term capital gain property donated to a nonoperating private foundation so th maximum donation is limited to 20% of AGI. The remaining deduction of $3,000 will carry ov year.

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103) Erika (age 62) was hospitalized with injuries from an auto accident this year. She incurred the follow expenses from the accident:

Hospital charges	$3,280
Prescription medicine	510
Doctor's fees	1,240

In addition, Erika's auto was completely destroyed in the accident. She bought the car several years a $18,000 and it was worth $4,700 at the time of the accident. What are Erika's itemized deductions thi year if she was uninsured and her AGI is $40,000?

Answer: $1,630 consisting of $1,030 of medical expenses and $600 of casualty losses.
The medical expenses of $5,030 are reduced by 10% of AGI ($4,000) and the casualty loss of $ reduced by $100 and 10% of AGI ($4,000).

104) Don's personal auto was damaged in a wind storm this year. Don purchased the auto several years ago for $32,000 and it was worth $18,000 at the time of the storm. The damage was superficial, so Don decided not to repair the car. Although Don collected $750 from his insurance company, the value of the car dropped after the storm to $15,000. What is the amount of casualty loss from the storm damage before Don applies any floor limitations?

Answer: $2,250
The loss is the lesser of the basis of the auto or the decline in value from the casualty reduced b insurance proceeds of $750. $2,250 = $3,000 − $750.

105) Colby is employed full time as a food technician for a local restaurant chain. This year he has incurre following expenses associated with his employment:

Transportation between various restaurants	$ 280
Technician uniforms (not adaptable to daily wear)	310
Professional dues and license	1,200

Colby was reimbursed $125 of the expenses from his employer's accountable plan. What amount can include with his remaining itemized deductions if his AGI this year is $32,000?

Answer: $1,025 = [($280 + $310 + $1,200) − $125] − (2% × $32,000)
All of the expenses are deductible but the deduction is reduced by the reimbursement and 2% o

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106) Clark is a registered nurse and full time employee of the Hays Hospital. To maintain his nursing licer has incurred the following expenses:

Nursing uniforms	$1,650
Union dues	400
Professional dues and license	800
Continuing education courses	450

Clark was reimbursed $1,250 of his expenses from his Hays Hospital accountable reimbursement pla What amount can he include with his remaining itemized deductions if his AGI this year is $52,000?

Answer: $\$1{,}010 = [(\$1{,}650 + \$400 + \$800 + \$450) - \$1{,}250] - (2\% \times \$52{,}000)$

All of the expenses are deductible but the deduction is reduced by the reimbursement and 2% c

107) Karin and Chad (ages 30 and 31, respectively) are married and together have $110,000 of AGI. This have recorded the following expenses:

Home mortgage interest	$6,640
Real estate taxes	5,400
State income taxes paid	6,300
Medical expenses (unreimbursed)	1,800
Employee business expenses (unreimbursed)	450
Charitable contributions (cash to their church)	760

Karin and Chad will file married joint with two personal exemptions. Calculate their taxable income.

Answer: $\$82{,}800 = \$110{,}000 - (\$6{,}640 + \$5{,}400 + \$6{,}300 + \$760) - (\$4{,}050 \times 2)$

Karin and Chad will choose to itemize their deductions. The medical expenses and employee b expenses will not generate any addition to the itemized deductions because they are subject to 2% of AGI floor limits, respectively.

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108) Rochelle, a single taxpayer (age 47), has an AGI of $275,200. This year, she paid medical expenses of $30,000, state income taxes of $4,000, mortgage interest of $10,600, and charitable contributions of $6,000. What would be the amount of her total itemized deductions that she may claim on her tax return?

Answer: Rochelle's itemized deductions for the year are $22,669.

Description	Amount
Taxes	$ 4,000
Mortgage interest	10,600
Charitable contributions	6,000
Total itemized deductions subject to phase-out	$ 20,600
Less phase-out of itemized deductions	− 411
Plus medical expense after 10% AGI floor (not subject to phase-out)	+ 2,480
Total itemized deductions	$ 22,669

Calculation of the phase-out:
Lesser of :
3 percent × (AGI minus $261,500) = 3 percent × ($275,200 − $261,500) = $411 or
(1) 80 percent of the total itemized deductions subject to phase-out ($20,600) = $16,480

109) Bryan is 62 years old and lives alone. This year he has received $25,000 in taxable interest and pensi payments, and he has paid the following expenses:

Real estate taxes	$1,640
Medical expenses ($2,000 was reimbursed by insurance)	3,650
Charitable contributions (cash to the Unity church)	460

If Bryan files single with one personal exemption, calculate his taxable income.

Answer: $13,050 = $25,000 − $7,900 − $4,050
Bryan's itemized deductions only total $2,100 (the unreimbursed medical expenses are eliminat the 10% of AGI floor limit), so Bryan will elect the standard deduction. Bryan's standard deduc increased by $1,550 for his age.

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110) Misti purchased a residence this year. Misti is a single parent and lives with her 1-year old daughter. Misti received a salary of $63,000 and made the following payments:

Home mortgage interest	$2,335
Real estate taxes	1,525
State income taxes paid	1,340
Income tax preparation fee	250
Charitable contributions (cash to their church)	120

Misti files as a head of household and claims two exemptions. Calculate her taxable income this year

Answer: $\$45{,}550 = \$63{,}000 - \$9{,}300 - (\$4{,}050 \times 2)$

Misti's itemized deductions total $5,320 (the income tax preparation fee is eliminated by the 2% floor limit). Hence, Misti will elect the standard deduction of $9,350.

111) Jon and Holly are married and live in a retirement community. This year Jon celebrated his 65th birthday and Holly turned 68 years old. For their ages, both Jon and Holly are in good health. This year the only significant expense that they incurred was an unreimbursed medical expense of $3,200. If Jon and Holly together have AGI of $42,000, what is the amount of their standard deduction this year?

Answer: $15,200

The married joint standard deduction is $12,700 increased by $2,500 because both taxpayers ar by year-end ($1,250 each).

112) This year Kelly bought a new auto for $20,000 plus $1,650 in state and local sales taxes. Besides this sales tax, Kelly also paid $8,260 in state income taxes and had other itemized deductions (e.g., mortgage interest) of $3,500. If Kelly files single with AGI of $56,000, what amount of itemized deductions will she be eligible to claim?

Answer: $11,760 = $8,260 + $3,500

State income taxes, but not sales taxes, are included with other itemized deductions when deter total itemized deductions. A taxpayer could elect to deduct state sales taxes instead of state inc taxes. Nonetheless, Kelly would not make this election because her state income taxes ($8,260) her state sales taxes.

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113) Toshiomi works as a sales representative and travels extensively for his employer's business. This ye
Toshiomi was paid $75,000 in salary and made the following expenditures:

State income taxes withheld	$6,300
Employee business expenses (unreimbursed portion)	1,450
Charitable contributions	200
Investment counseling fees	780
Tax preparation fee	310

Toshiomi also made a number of trips to Las Vegas for gambling. This year Toshiomi won $12,000 i
tournament and this amount was almost enough to offset his other gambling losses ($13,420). Calcul
Toshiomi's taxable income if he files single with one personal exemption.

Answer: $63,650 = 67,700 − 4,050 (personal exemption)
$67,700 = ($75,000 salary + $12,000 gambling winnings) − ($6,300 state taxes + $12,000 gambling losses) − [($1,450 unreimbursed employee business expenses + $780 investment fees + $310 tax preparation fees) − ($87,000 × 2%)] − 200 charitable contributions
The employee expenses, investment fees, and tax preparation fee are all miscellaneous itemize deductions subject to a 2% of AGI limit. The gambling losses (up to gambling winnings) are a miscellaneous itemized deduction not subject to the 2% of AGI limit, and the state income taxes and charitable contributions are also itemized deductions.

114) Justin and Georgia file married jointly with one dependent. This year, their AGI is $327,800. What dollar amount of personal and dependency exemptions would they be allowed to deduct this year?

Answer: $10,692

	Amount	Explanation
Step 1:	$ 14,000	$327,800 − 313,800 (Excess AGI).
Step 2:	$ 6	Divide $14,000 by 2,500 and round up to nearest whole number $14,000/2,500 = 5.6 → 6.
Step 3:	12 %	Multiply the amount in Step 2 by 2% (i.e., 6 × 2%).
Step 4:	$ 1,458	Multiply the Step 3 result by the total exemption amount (i.e., $12,150 × 12%). This is the amount of the phase-out.
Step 5:	$ 10,692	Subtract the Step 4 result from the total exemption amount (i.e., $12,150 − $1,458). This is the deductible exemption amount.

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1) TRUE
2) FALSE
3) FALSE
4) TRUE
5) TRUE
6) TRUE
7) FALSE
8) TRUE
9) FALSE
10) FALSE
11) FALSE
12) TRUE
13) TRUE
14) FALSE
15) TRUE
16) TRUE
17) FALSE
18) FALSE
19) TRUE
20) FALSE
21) TRUE
22) FALSE
23) TRUE
24) FALSE
25) TRUE
26) TRUE
27) FALSE
28) FALSE
29) TRUE
30) TRUE
31) FALSE
32) C
33) A
34) E
35) C
36) C
37) A
38) B
39) A
40) A
41) E
42) D
43) B
44) C
45) A
46) D
47) E
48) B
49) E
50) D

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51) B
52) E
53) E
54) A
55) B
56) E
57) A
58) E
59) C
60) E
61) B
62) A
63) A
64) E
65) B
66) C
67) D
68) C
69) B
70) D
71) D
72) C
73) A
74) B
75) D
76) B
77) E
78) B
79) D
80) A
81) E
82) C
83) B
84) B
85) A
86) A
87) A
88) $15,500
$15,500 = $1,300 + $6,250 + $500 + $50 + $7,200 + ($400 *.50). All of the expenses are deductible for AC
Scott's health insurance and 50 percent of the self-employment tax.
89) The move qualifies for a deduction of $832.
The move qualifies under the distance test (commute of 25 miles is extended by 75 miles to 100 miles), anc
associated with transportation and the moving van are deductible for AGI.
90) $76,669
All of the expenses are deductible, except only 50% of the self-employment tax is deductible ($6,351).
91) none
The tuition, books, room/board and transportation are not deductible because they will qualify Shelby for a
(lawyer).

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92) $1,250
The deduction for student loan interest is reduced for single taxpayers with AGI above $65,000 but below $
The deduction is the amount paid up to $2,500, reduced by the phase-out percentage. The percentage is equ
$72,500 less $65,000 divided by $15,000. In this problem, there is a phase out of 50 percent ($7,500/$15,0(
reducing the amount paid up to $2,500 (in this case, $2,500) to a deduction of $1,250 [$2,500 − ($2,500 × ($7,500/$15,000)) = $1,250].

93) $2,250 for interest and $2,000 for qualified education expenses.
The deduction for student loan interest is reduced for taxpayers with AGI above $135,000 but below $165,(
deduction is the amount paid up to $2,500, reduced by the phase-out percentage. The percentage is equal to
less $135,000 divided by $30,000. This results in a phase out of 10 percent ($3,000/$30,000) thereby reduc
maximum to $2,250 [$2,500 − ($2,500 × ($3,000/$30,000)) = $2,250]. Since Collin and Christine's modified AGI ($138,000 − $2,250 education interest deduction = $135,750) exceeds $130,000 (but not $160,000), they may deduct the $22,000 tuition expense paid up to the $2,000 maximum deduction.

94) $72,514 = $85,000 − $12,486
The books on investing, advertising for investment clients, repairs for the rental property, 50% of the self e
taxes, and health insurance premiums are deductible for AGI. The whole life insurance premiums are not d
and the state income taxes are only deductible from AGI.

95) $71,250 ($62,700 + $12,000 − $2,200 - $1,250 = $71,250)
The alimony and salary are income, and the moving expense and part of the educational interest are deducti
AGI. Tiffanie's maximum educational interest deduction (amount paid up to $2,500) is limited to $1,250. T
deduction for educational interest ($2,500) is subject to phase-out because Tiffanie's modified AGI exceeds
The phase out is calculated by subtracting $65,000 from Tiffanie's modified AGI ($62,700 + $12,000 − $2,200 = $72,500) and dividing by $15,000 as follows: $2,500 * [($72,500 − $65,000)/$15,000] = $1,250. Thus, the amount deductible is $1,250 [$2,500 − $1,250 = $1,250].

96) $1,000 = $5,200 − [2% × ($204,800 + $5,200)]
Detmer's hobby expenses of $6,335 are limited to his revenues ($5,200) and further reduced by $4,200 (2 p
AGI which is $204,800 + $5,200).

97) $1,910
All expenses are qualified medical expenses except for the cosmetic surgery and over-the-counter drugs. H
medical expense deduction is $5,910 less $4,000 (10 percent*40,000) = $1,910 and this amount is included
itemized deductions.

98) $4,050 = $1,900 + $850 + $790 + $510
The deductible taxes include county real estate, school district tax on real estate. State income taxes paid ar
withheld are also deductible.

99) Homer's hobby will increase his taxable income by $750.
Homer will not receive any deduction for the hobby expenses, but the hobby income will increase taxable i
The deduction for hobby expenses ($2,320) is limited to hobby revenues ($750) and further reduced by $1,(
percent of AGI which is $80,000 + $750).

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100) $38,000.
Benjamin's acquisition debt on his home and vacation home does not exceed $1,000,000. Thus, he can ded $20,000 mortgage interest on his home and $10,000 of mortgage interest on his vacation home. Because hi equity debt exceeds $100,000, he can only deduct a portion of the interest on the $150,000 home equity de portion attributable to $100,000 of debt). Thus, Benjamin can also deduct $8,000 of home equity interest ($12,000 interest expense × ($100,000 home equity debt limit/$150,000 home equity debt amount) = $8,000).

101) The charitable deduction is $21,000 for the painting and $40,000 overall.

All of the contributions are to public charities, and the overall limit is 50 percent of AGI ($40,000). The ca and clothes are subject to the 50 percent of AGI limit. The stock and clothes are not subject to the 30 perce limit because these are ordinary income properties (basis exceeds its value so neither is capital gain property). Thus, $19,000 is the deduction in the first step of the calculation. The painting is long-term tangible personal property apparently related to the purpose of the charity. Hence, the maximum deduction is the lesser of (1) the value up to the 30 percent AGI limit ($24,000) or (2) the remaining amount of deduc to reach the 50 percent limit ($21,000). Hence, the maximum deduction this year is $40,000 consisting of c $8,000, IBM stock of $10,500, clothes of $500, and the painting of $21,000. The remaining value of the pa $24,000 ($45,000 − $21,000) is carried over to next year subject to the 30 percent of AGI limit.

50 percent AGI limit		$ 40,000
50 percent Contributions - cash	8,000	
50 percent Contributions - clothes	500	
50 percent Contributions – stock	+ 10,500	
Total 50 percent contributions		- 19,000
Maximum remaining contribution to reach 50 percent		$ 21,000

102) $12,000
The stock is long-term capital gain property donated to a nonoperating private foundation so the maximum limited to 20% of AGI. The remaining deduction of $3,000 will carry over to next year.

103) $1,630 consisting of $1,030 of medical expenses and $600 of casualty losses.
The medical expenses of $5,030 are reduced by 10% of AGI ($4,000) and the casualty loss of $4,700 is red $100 and 10% of AGI ($4,000).

104) $2,250
The loss is the lesser of the basis of the auto or the decline in value from the casualty reduced by insurance of $750. $2,250 = $3,000 − $750.

105) $1,025 = [($280 + $310 + $1,200) − $125] − (2% × $32,000)
All of the expenses are deductible but the deduction is reduced by the reimbursement and 2% of AGI.

106) $1,010 = [($1,650 + $400 + $800 + $450) − $1,250] − (2% × $52,000)
All of the expenses are deductible but the deduction is reduced by the reimbursement and 2% of AGI.

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107) $82,800 = $110,000 − ($6,640 + $5,400 + $6,300 + $760) − ($4,050 × 2)
Karin and Chad will choose to itemize their deductions. The medical expenses and employee business expe not generate any addition to the itemized deductions because they are subject to 10% and 2% of AGI floor l respectively.

108) Rochelle's itemized deductions for the year are $22,669.

Description		Amount
Taxes	$	4,000
Mortgage interest		10,600
Charitable contributions		6,000
Total itemized deductions subject to phase-out	$	20,600
Less phase-out of itemized deductions	−	411
Plus medical expense after 10% AGI floor (not subject to phase-out)	+	2,480
Total itemized deductions	$	22,669

Calculation of the phase-out:
Lesser of :
3 percent × (AGI minus $261,500) = 3 percent × ($275,200 − $261,500) = $411 or
(1) 80 percent of the total itemized deductions subject to phase-out ($20,600) = $16,480

109) $13,050 = $25,000 − $7,900 − $4,050
Bryan's itemized deductions only total $2,100 (the unreimbursed medical expenses are eliminated by the 1(floor limit), so Bryan will elect the standard deduction. Bryan's standard deduction is increased by $1,550 f

110) $45,550 = $63,000 − $9,300 − ($4,050 × 2)
Misti's itemized deductions total $5,320 (the income tax preparation fee is eliminated by the 2% of AGI flo Hence, Misti will elect the standard deduction of $9,350.

111) $15,200
The married joint standard deduction is $12,700 increased by $2,500 because both taxpayers are age 65 by ($1,250 each).

112) $11,760 = $8,260 + $3,500
State income taxes, but not sales taxes, are included with other itemized deductions when determining total deductions. A taxpayer could elect to deduct state sales taxes instead of state income taxes. Nonetheless, K would not make this election because her state income taxes ($8,260) exceed her state sales taxes.

113) $63,650 = 67,700 − 4,050 (personal exemption)
$67,700 = ($75,000 salary + $12,000 gambling winnings) − ($6,300 state taxes + $12,000 gambling losses) − [($1,450 unreimbursed employee business expenses + $780 investment fees + $310 tax preparation fees) − ($87,000 × 2%)] − 200 charitable contributions
The employee expenses, investment fees, and tax preparation fee are all miscellaneous itemized deductions subject to a 2% of AGI limit. The gambling losses (up to gambling winnings) are a miscellaneous itemized deduction not subject to the 2% of AGI limit, and the state income taxes and charitable contributions are also itemized deductions.

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114) $10,692

	Amount	Explanation
Step 1:	$ 14,000	$327,800 − 313,800 (Excess AGI).
Step 2:	$ 6	Divide $14,000 by 2,500 and round up to nearest whole number $14,000/2,500 = 5.6 → 6.
Step 3:	12 %	Multiply the amount in Step 2 by 2% (i.e., 6 × 2%).
Step 4:	$ 1,458	Multiply the Step 3 result by the total exemption amount (i.e., $12,150 × 12%). This is the amount of the phase-out.
Step 5:	$ 10,692	Subtract the Step 4 result from the total exemption amount (i.e., $12,150 − $1,458). This is the deductible exemption amount.

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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
Sarah	Hamblin	123-43-4321
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.

1245 Rose Petal Drive

▲ 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).

Madison WI 53562

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. ▶ Elizabeth Hamblin

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	34,350.
8a	**Taxable** interest. Attach Schedule B if required		8a	565.
b	**Tax-exempt** interest. **Do not** include on line 8a	8b 250.		
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	16,000.
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	11,000.
18	Farm income or (loss). Attach Schedule F		18	
19	Unemployment compensation		19	1,250.
20a	Social security benefits 20a	b Taxable amount	20b	
21	Other income. List type and amount Radio Contest Winnings		21	2,000.
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	65,165.

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		
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	
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37	65,165.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. BAA REV 01/25/17 TTW Form **1040** (2016)

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Tax and Credits

38	Amount from line 37 (adjusted gross income)	38	65,165.
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** ☐		
40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)	40	9,300.
41	Subtract line 40 from line 38	41	55,865.
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	51,815.
44	**Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐	44	7,254.
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	7,254.
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	7,254.

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

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	7,254.

Payments

If you have a qualifying child, attach Schedule EIC.

64	Federal income tax withheld from Forms W-2 and 1099	64	6,950.
65	2016 estimated tax payments and amount applied from 2015 return	65	
66a	**Earned income credit (EIC)** No	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	6,950.

Refund

75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**	75	
76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	76a	
b	Routing number X X X X X X X X X ▶ **c** Type: ☐ Checking ☐ Savings		
d	Account number X X X X X X X X X X X X X X X X X		
77	Amount of line 75 you want **applied to your 2017 estimated tax** ▶ 77		

Direct deposit? See instructions. ▶ b ▶ d

Amount You Owe

78	**Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶	78	304.
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
		Clerk	
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 ▶ Self-Prepared			Firm's EIN ▶	
Firm's address ▶			Phone no.	

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Name(s) shown on return. Do not enter name and social security number if shown on other side. | Your social security number

Sarah Hamblin | 123-43-4321

Caution: The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

Part II Income or Loss From Partnerships and S Corporations

Note: If you report a loss from an at-risk activity for which **any** amount is **not** at risk, you **must** check the box in column **(e)** on line 28 and attach **Form 6198.** See instructions.

27 Are you reporting any loss not allowed in a prior year due to the at-risk, excess farm loss, or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses? If you answered "Yes," see instructions before completing this section. ☐ Yes ☒ No

28	(a) Name	(b) Enter P for partnership; S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if any amount is not at risk
A	Bright Day Flowers, Inc.	S	☐	56-3535353	☐
B			☐		☐
C			☐		☐
D			☐		☐

	Passive Income and Loss		Nonpassive Income and Loss		
	(f) Passive loss allowed (attach Form 8582 if required)	(g) Passive income from Schedule K-1	(h) Nonpassive loss from Schedule K-1	(i) Section 179 expense deduction from Form 4562	(j) Nonpassive income from Schedule K-1
A					11,000.
B					
C					
D					
29a Totals					11,000.
b Totals					

30	Add columns (g) and (j) of line 29a	30	11,000.
31	Add columns (f), (h), and (i) of line 29b	31	( )
32	**Total partnership and S corporation income or (loss).** Combine lines 30 and 31. Enter the result here and include in the total on line 41 below	32	11,000.

Part III Income or Loss From Estates and Trusts

33	(a) Name	(b) Employer identification number
A		
B		

	Passive Income and Loss		Nonpassive Income and Loss	
	(c) Passive deduction or loss allowed (attach Form 8582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A				
B				
34a Totals				
b Totals				

35	Add columns (d) and (f) of line 34a	35	
36	Add columns (c) and (e) of line 34b	36	( )
37	**Total estate and trust income or (loss).** Combine lines 35 and 36. Enter the result here and include in the total on line 41 below	37	

Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs)—Residual Holder

38	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules Q, line 2c (see instructions)	(d) Taxable income (net loss) from Schedules Q, line 1b	(e) Income from Schedules Q, line 3b

39	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below	39	

Part V Summary

40	Net farm rental income or (loss) from **Form 4835**. Also, complete line 42 below	40	
41	**Total income or (loss).** Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Form 1040, line 17, or Form 1040NR, line 18 ▶	41	11,000.
42	**Reconciliation of farming and fishing income.** Enter your **gross** farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120S), box 17, code V; and Schedule K-1 (Form 1041), box 14, code F (see instructions)	42	
43	**Reconciliation for real estate professionals.** If you were a real estate professional (see instructions), enter the net income or (loss) you reported anywhere on Form 1040 or Form 1040NR from all rental real estate activities in which you materially participated under the passive activity loss rules	43	

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Chapter 2
Tax Compliance, the IRS, and Tax Authorities

INSTRUCTOR'S MANUAL

Learning Objectives

1. Identify the filing requirements for income tax returns and the statute of limitations for assessment.
2. Outline the IRS audit process, how returns are selected, the different types of audits, and what happens after the audit.
3. Evaluate the relative weights of the various tax law sources.
4. Describe the legislative process as it pertains to taxation.
5. Perform the basic steps in tax research and evaluate various tax law sources when faced with ambiguous statutes.
6. Describe tax professional responsibilities in providing tax advice.
7. Identify taxpayer and tax professional penalties.

Teaching Suggestions

This chapter provides a summary of the filing requirements for income tax returns, the IRS audit process, tax law sources and tax research, tax professional responsibilities, and taxpayer and tax practitioner penalties. The time allotted to this chapter will vary based on your expectations regarding the students' abilities to conduct research in the course. The remaining material in the chapter (filing requirements, IRS audit process, tax professional responsibilities, and taxpayer and tax practitioner penalties) can be covered in a class session (or two).

Compared to Chapter 1 and later chapters, the material in Chapter 2 could be considered somewhat "dry." Thus, it is important to bring this material to life in the classroom as much as possible. Some suggestions for the class discussion include:

- Filing requirements – provide a basic overview of the filing requirements by entity and statute of limitations and then use discussion questions 1 through 3 and problems 43 – 49 to quiz students on their understanding.
- IRS audit process – most students are interested in how the IRS selects returns for audit. Discussing high-profile IRS cases (Richard Hatch, *Survivor*; Willie Nelson; Al Capone) or personal experiences with IRS audits is typically well received. After the discussion, quizzing the students on identifying the selection method and audit type for various fact patterns is an effective way to make sure that your students can apply the concepts from this discussion.
- Tax law sources – the depth you cover the various sources will vary with your expectations regarding the students' abilities to conduct research. If students will be expected to research problems, read primary authorities, etc., then showing examples of the specific types of authorities that they will research (code sections, regulations, etc.), highlighting their attributes, contrasting different authorities, and discussing how to locate the authorities and make sure that they are "current" should prove beneficial. This discussion could then be followed with a discussion of how to conduct research and an in-class example of a simple research problem. [As an out of class exercise, you might assign students to locate specific

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primary authorities (e.g., court cases, revenue rulings, etc.) and related discussion in an available tax service (CCH, RIA, BNA, etc.) and have the students summarize the issue addressed in the primary authority and tax service and how they located each authority.]

If instead, students are simply required to have a basic understanding of tax authorities with little or no research expectation, most of the discussion of authorities could focus on comparing different authorities and their relative weights. This discussion can then be reinforced with classroom questions comparing the weight of different authorities or contrasting different authorities using the "one vs. the group" activity suggested below.

- Tax legislation: This discussion may be aided by displaying Exhibit 2-7. You may also remind your class of the ABC Schoolhouse Rock song, "I'm Just A Bill," that highlights the legislative process. You can download this song on YouTube.
- Basic tax research steps: This discussion may be enhanced by walking students through the research example in the text or through one of the end of chapter research problems.
- Tax professional standards/Taxpayer and tax practitioner penalties: This discussion may be enhanced by a discussion of the IRS' crackdown on tax shelters, the dire consequences associated with not meeting professional standards, and the recent increased thresholds to avoid tax practitioner penalties.

Assignment Matrix

			Learning Objectives							Text Feature		
		Difficulty	LO1	LO2	LO3	LO4	LO5	LO6	LO7	Research	Planning	Forms
DQ2-1	15 min.	Medium	X									
DQ2-2	15 min.	Medium	X									
DQ2-3	15 min.	Medium	X									
DQ2-4	15 min.	Medium		X								
DQ2-5	15 min.	Medium		X								
DQ2-6	15 min.	Medium		X								
DQ2-7	10 min.	Easy		X								
DQ2-8	10 min.	Medium		X								
DQ2-9	10 min.	Easy			X							
DQ2-10	10 min.	Medium			X							
DQ2-11	10 min.	Medium			X							
DQ2-12	10 min.	Medium			X							
DQ2-13	10 min.	Medium			X							
DQ2-14	10 min.	Easy			X							
DQ2-15	10 min.	Easy			X							
DQ2-16	15 min.	Medium			X							
DQ2-17	15 min.	Medium			X							
DQ2-18	15 min.	Medium			X							
DQ2-19	15 min.	Medium				X						
DQ2-20	10 min.	Easy				X						
DQ2-21	10 min.	Easy				X						

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DQ2-22	10 min.	Easy				X						
DQ2-23	10 min.	Easy					X					
DQ2-24	10 min.	Easy					X					
DQ2-25	10 min.	Easy					X					
DQ2-26	10 min.	Easy					X					
DQ2-27	15 min.	Medium					X					
DQ2-28	15 min.	Medium					X					
DQ2-29	15 min.	Medium					X					
DQ2-30	15 min.	Medium					X					
DQ2-31	15 min.	Medium					X					
DQ2-32	15 min.	Medium					X					
DQ2-33	15 min.	Medium					X					
DQ2-34	15 min.	Medium					X					
DQ2-35	15 min.	Medium					X					
DQ2-36	10 min.	Easy						X				
DQ2-37	10 min.	Easy						X				
DQ2-38	10 min.	Easy						X				
DQ2-39	10 min.	Easy							X			
DQ2-40	15 min.	Medium							X			
DQ2-41	15 min.	Medium							X			
DQ2-42	15 min.	Medium							X			
P2-43	15 min.	Medium	X									
P2-44	15 min.	Medium	X									
P2-45	15 min.	Medium	X									
P2-46	15 min.	Medium	X									
P2-47	15 min.	Medium	X									
P2-48	15 min.	Medium	X									
P2-49	15 min.	Medium	X									
P2-50	10 min.	Medium		X								
P2-51	10 min.	Medium		X								
P2-52	10 min.	Medium		X								
P2-53	10 min.	Medium		X								
P2-54	10 min.	Medium		X								
P2-55	10 min.	Medium		X								
P2-56	10 min.	Medium		X								
P2-57	10 min.	Medium		X								
P2-58	15 min.	Medium			X							
P2-59	15 min.	Medium			X							
P2-60	15 min.	Medium			X							
P2-61	15 min.	Medium			X							
P2-62	15 min.	Medium			X							
P2-63	15 min.	Medium			X							
P2-64	10 min.	Easy				X						
P2-65	15 min.	Medium					X					
P2-66	15 min.	Medium					X					
P2-67	15 min.	Medium					X					

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P2-68	15 min.	Medium					X					
P2-69	15 min.	Medium					X					
P2-70	15 min.	Medium					X					
P2-71	15 min.	Medium					X					
P2-72	15 min.	Medium					X					
P2-73	15 min.	Medium					X					
P2-74	15 min.	Medium					X					
P2-75	15 min.	Medium					X					
P2-76	10 min.	Easy						X				
P2-77	10 min.	Easy						X				
P2-78	15 min.	Medium							X			
P2-79	15 min.	Medium							X			

Lecture Notes

1) Taxpayer Filing Requirements
   a) Filing requirements by entity
      i) Individuals (show Exhibit 2-1)
      ii) Corporations
   b) Tax return due date and extensions
      i) Individuals and C corporations
      ii) Partnerships and S corporations
   c) Statute of limitations
      i) The period in which the taxpayer can file an amended tax return or the IRS can assess a tax deficiency for a specific tax year.
      ii) Generally ends three years from the *later* of (1) the date the tax return was actually filed or (2) the tax return's original due date.
      iii) A six-year statute of limitations applies to IRS assessments if the taxpayer omits items of gross income that exceed 25 percent of the gross income reported on the tax return.
      iv) For fraudulent returns, or if the taxpayer fails to file a tax return, the statute of limitations remains open indefinitely in these cases.
2) IRS Audit Selection
   a) Methods of selection
      i) DIF system
      ii) Document perfection
      iii) Information matching
      iv) Other methods
   b) Types of audits
      i) Correspondence
      ii) Office
      iii) Field
   c) After the audit (show Exhibit 2-2)
      i) Proposed adjustment
      ii) 30-day letter
      iii) Appeals conference
      iv) 90-day letter
      v) Petition courts
      vi) Trial level courts and their differences: Tax Court, U.S. District Court, U.S. Court of Federal Claims

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vii) Choosing a trial level court (show Exhibit 2-3)
viii) Circuit Court of Appeals (show Exhibit 2-4)
ix) Supreme Court

3) Tax Law Sources
   a) Primary and secondary sources
      i) Primary tax authorities (show Exhibit 2-5)
      ii) Secondary authorities (show Exhibit 2-6)
   b) Legislative sources: Congress and the Constitution
      i) U.S. Constitution
      ii) Internal Revenue Code
      iii) Legislative process for tax laws (show Exhibit 2-7)
      iv) Basic organization of the code (show Exhibit 2-8)
      v) Tax treaties
   c) Judicial sources: the courts
      i) The hierarchy of the courts (trial level, appeals, Supreme Court)
      ii) *Stare decisis*
      iii) Golsen rule
   d) Administrative sources: the U.S. Treasury
      i) Regulations: 3 different forms (Final, Temporary, Proposed); 3 different purposes (Interpretative, Procedural, Legislative); Highest administrative authority.
      ii) Revenue Rulings and Revenue Procedures – more detailed than regulations; 2nd in administrative weight. Definition of each.
      iii) Letter rulings: lower authoritative weight; contrast private letter rulings with determination letters and technical advice memorandums.
      iv) Acquiescence, nonacquiescence, and actions on decision: define and explain why important.
4) Tax Research
   a) Understand facts
      i) Open and closed facts
      ii) How do you determine facts for a research question?
   b) Identify issues
      i) Ability to identify issues varies with experience
      ii) Understand facts, combine facts with understanding of law, identify general issues (Is this income taxable? Is this expense deductible?)
      iii) Research will allow you to identify more specific issues
      iv) Discuss Example 2-4 in class
   c) Locate relevant authorities
      i) Annotated tax services – definition and what they contain
      ii) Topical tax services – definition and what they contain
      iii) How to use these services?
      iv) Keyword search – area of law and key facts; suggestions if key word searching is not proving beneficial
      v) Topical index
      vi) Browsing the service
      vii) Discuss Example 2-5
   d) Analyze tax authorities
      i) Questions of fact: hinges upon the facts and circumstances of the taxpayer's transaction. In this type of question, the researcher will focus on understanding how various facts affect the research answer and identifying authorities with fact patterns similar to her client's.
      ii) Questions of law: hinges upon the interpretation of the law, such as interpreting a particular phrase in a code section. If a researcher is faced with this type of question, she will spend

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much of her time researching the various interpretations of the code section and take note of which authorities interpret the code differently and why.

iii) Conflicting authorities: the tax researcher should evaluate the hierarchical level, jurisdiction, and age of the authorities, placing more weight on higher and newer authorities that have jurisdiction over the taxpayer.

iv) Checking the status of authorities: citators and methods to check the status of authorities.

e) Document and communicate the results

i) The basic parts of a memo: facts, issues, authorities, conclusion, and analysis.

ii) Facts: Discuss facts that provide necessary background of the transaction and those facts that may influence the research answer.

iii) Issues: State the specific issues that the memo addresses. Issues should be written as specifically as possible and be limited to one or two sentences per issue.

iv) Authorities: the researcher cites the relevant tax authorities that apply to the issue, such as the IRC, court cases, and revenue rulings. Cite enough to provide a clear understanding of the issue and interpretation of the law.

v) Conclusion: One conclusion per issue. Each conclusion should answer the question as briefly as possible, and, preferably, indicate why the answer is what it is.

vi) Analysis: The goal of the analysis is for the researcher to provide the reader a clear understanding of the area of law and specific authorities that apply. Typically an analysis will be organized to discuss the general area(s) of law first (the code section) and then the specific authorities (court cases, revenue rulings) that apply to the research question. After you discuss the relevant authorities, apply the authorities to your client's transaction and explain how the authorities result in your conclusion.

vii) The basic parts of a client letter: salutation & social graces, research question and limitations, facts, analysis, and closing.

5) Tax Professional Responsibilities

a) Tax professionals are subject to various statutes, rules, and codes of conduct

i) AICPA Code of Professional Conduct

ii) AICPA Statements on Standards for Tax Services

iii) IRS' Circular 230

iv) State Board of Accountancy Statutes

b) Failure to comply with statutes can result in being admonished, suspended, or barred from practicing

6) Taxpayer and tax practitioner penalties

a) Civil penalties

i) Generally in monetary penalties

ii) Imposed when tax practitioners or taxpayers violate tax statutes without reasonable cause

b) Criminal penalties

i) Much less common than civil penalties

ii) Penalties are much higher and can include prison sentences

c) **Taxpayer** underpayment penalty - no underpayment penalty if there is ***substantial authority*** that supports the tax return position or if there is a reasonable basis for the position and it is disclosed on the taxpayer's tax return

d) A **tax practitioner** will not be subject to penalty if there is ***substantial authority*** that supports the tax return position or if there is a reasonable basis for the position and it is disclosed on the taxpayer's tax return

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Class Activities

1. Suggested class activities

- **Let's choose a court**: Split the class into groups. Explain to the class that you will be asking a series of questions regarding the choice of trial level courts after an audit. After you ask the question, a group may buzz in to answer the question when a group member raises his or her hand. If the person gets the question correct, the group will receive one point. If the person misses the question, the group loses one point. The group with the most points at the end of the series of questions will receive bonus participation points for the day. Use the individual court differences and the differences in their respective appellate court to generate questions. See problem 57 for examples of questions to pose.
- **One versus the class**: Have one student volunteer as the "one" with the other class members being the "group." Use the "Key Facts" boxes in the text to develop basic multiple-choice questions (A, B, C answers) and then quiz the volunteer and the class on the questions. The volunteer and each class member will need to write the letters A, B, and C on separate sheets of paper and then hold up their appropriate response to the question. Once a student (either the "one" or a member of the "group") misses a question, her or she is eliminated from the competition. After 6 (or some other number) of questions, those students left standing receive bonus participation points for the day.

2. Research activities

- Take one or more of the research problems at the end of the chapter and pose the following questions after reading the problem: (1) What are the key facts in the problem? (2) What is the general issue to be addressed? (3) What key words would you use to research this question? Then walk the students through how you would conduct the research using an available on-line service.

3. Ethics Discussion

From page 2-5:

ETHICS

After Bill and Mercedes's tax return was selected for audit, Bill read on the Internet speculation that filing a paper copy tax return (instead of filing electronically) and extending a tax return decrease the chance of IRS audit. Bill has convinced Mercedes that they need to use these strategies going forward and look for other ways to avoid audit. Has Bill crossed an ethical boundary?

Discussion points:

- What are the timing requirements for filing a tax return and paying taxed owed?
- Does Bill's action likely violate any IRS regulation?
- If Bill's action does not violate IRS rules, is it ethical?
- Are ethics and IRS rules the same?

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Tax Return-Individual Number Two (after Chapter 5)

Instructions:

Please complete the 2016 federal income tax return for Sarah Hamblin. Be sure to include only **required** tax forms when completing the tax return. For purposes of this assignment, unless instructed otherwise, you do not need to attach Form 8582. Also, ignore the requirement to attach the Form(s) W-2 to the front page of the Form 1040. If required information is missing, use reasonable assumptions to fill in the gaps.

Sarah Hamblin and her now ex-husband Kevin were legally divorced on March 1, 2016. As of the end of the year, Sarah was unmarried. Sarah and Kevin had only one child, an 11 year old girl named Elizabeth. As part of the divorce decree, Sarah was given custody of Elizabeth and Kevin was required to pay 1) child support for Elizabeth's care, and 2) alimony to Sarah until she remarries or dies. Because Kevin will be making child support payments, the divorce decree provided that Kevin will be permitted to claim the tax dependency exemption for Elizabeth until Elizabeth no longer qualifies as a tax dependent of either parent and the decree obligates Sarah to sign and/or file any required forms to cause this result to occur.

Sarah rents a home (separate from Kevin) that she pays for herself. Elizabeth lives with Sarah most of the time but she visits and stays with her father every other weekend and most holidays. During the year, Elizabeth stayed at Kevin's house a total of 74 nights.

Sarah provided the following information for 2016:

- Sarah's Social Security number is 123-43-4321
- Elizabeth's Social Security number is 123-34-1234
- Sarah's mailing address is 1245 Rose Petal Drive, Madison, Wisconsin 53562
- Elizabeth is a U.S .citizen

The following was reported on Sarah's Form W-2:

Employer	Gross Wages	Federal Income Tax Withholding	State Income Tax Withholding
Central Wisconsin Heating and Air	34,350	6,950	2,125

All applicable and appropriate payroll taxes were withheld by the employer.

During the year, Sarah also received the following:

Child Support Payment from Kevin Hamblin	$12,000
Alimony Payment from Kevin Hamblin	$16,000
Gift from her father to help with legal bills	$ 8,500
Interest income on U.S. Treasury Bond	$ 400
Interest income of Madison City Bond (municipal bond)	$ 250
Interest income from First Bank of Madison	$ 165
Life insurance proceeds on the death of her mother	$45,000

Sarah is a 50% owner in a friend's company, Bright Day Flowers, Inc. Bright Day Flowers, Inc. (BDF) is a Subchapter S corporation. The company reported ordinary business income for the year of $22,000. Sarah acquired the stock several years ago. Sarah worked a total of 600 hours at the BDF shop in the evenings and on the weekends during 2016. Bright Day Flowers, Inc.'s employer identification number is 56-3535353.

Sarah entered a contest sponsored by a radio station and won 10 tickets to the touring Broadway-style production of Wholesome. The value of the tickets was $200 each. Sarah took her friends from work to the production.

Sarah lost her job with Central Wisconsin Heating and Air on November 15 because of a reduction in work force. She collected $1,250 in unemployment benefits during the year. She is currently looking for another job.

Sarah had qualifying minimum health insurance coverage provided to her because of her employment with Central Wisconsin Heating and Air for each month in 2016 (the employer continued to cover her through the end of the year). Elizabeth had qualifying minimum health insurance coverage provided through Kevin through his work.

Sarah did not own, control or manage any foreign bank accounts nor was she a grantor or beneficiary of a foreign trust during the tax year.

Sarah was provided with the following benefits as part of her employment:

- Group-term life insurance coverage of $50,000. The cost to cover Sarah for the company for the tax year is $150.

- Access to the company photocopy machine. Sarah estimates she made $14 worth of copies during the year primarily for use with her church group activities.

Sarah reported no itemized deductions other than any described above.

Sarah does not want to contribute to the Presidential Election Campaign Fund. She would like to receive a refund (if any) of any tax she may have overpaid for the year. Her preferred method of receiving the refund is by check.

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
Johnelle	Henry	5 5 5 1 2 6 7 8 9
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Latoya	Henry	9 8 7 6 5 4 3 2 1

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

9876 Old Waverly

▲ 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).

Charleston, SC 29401

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: 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)
			☐
			☐
			☐
			☐

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 ▶ 2

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	130,000
8a	**Taxable** interest. Attach Schedule B if required		8a	
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	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 Lottery Winning		21	5,000
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	135,000

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		
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	
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37	135,000

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 11320B Form **1040** (2016)

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Tax and Credits

38	Amount from line 37 (adjusted gross income)	38	135,000
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 ☐		
40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)	40	35,020
41	Subtract line 40 from line 38	41	99,980
42	**Exemptions.** If line 38 is $155,650 or less, multiply $4,050 by the number on line 6d. Otherwise, see instructions	42	8,100
43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	91,880
44	**Tax** (see instructions). Check if any from: a ☐ Form(s) 8814 b ☐ Form 4972 c ☐	44	14,511
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	14,511
48	Foreign tax credit. Attach Form 1116 if required		
49	Credit for child and dependent care expenses. Attach Form 2441		
50	Education credits from Form 8863, line 19		
51	Retirement savings contributions credit. Attach Form 8880		
52	Child tax credit. Attach Schedule 8812, if required		
53	Residential energy credits. Attach Form 5695		
54	Other credits from Form: a ☐ 3800 b ☐ 8801 c ☐		
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	14,511

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

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	14,511

Payments

If you have a qualifying child, attach Schedule EIC.

64	Federal income tax withheld from Forms W-2 and 1099	64	20,000
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	20,000

Refund

75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**	75	5,489
76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	76a	5,489
▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings		
▶ d	Account number		
77	Amount of line 75 you want **applied to your 2017 estimated tax** ▶ 77		

Direct deposit? See instructions.

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
		Human Resource 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.)
		Financial Planner	

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.	

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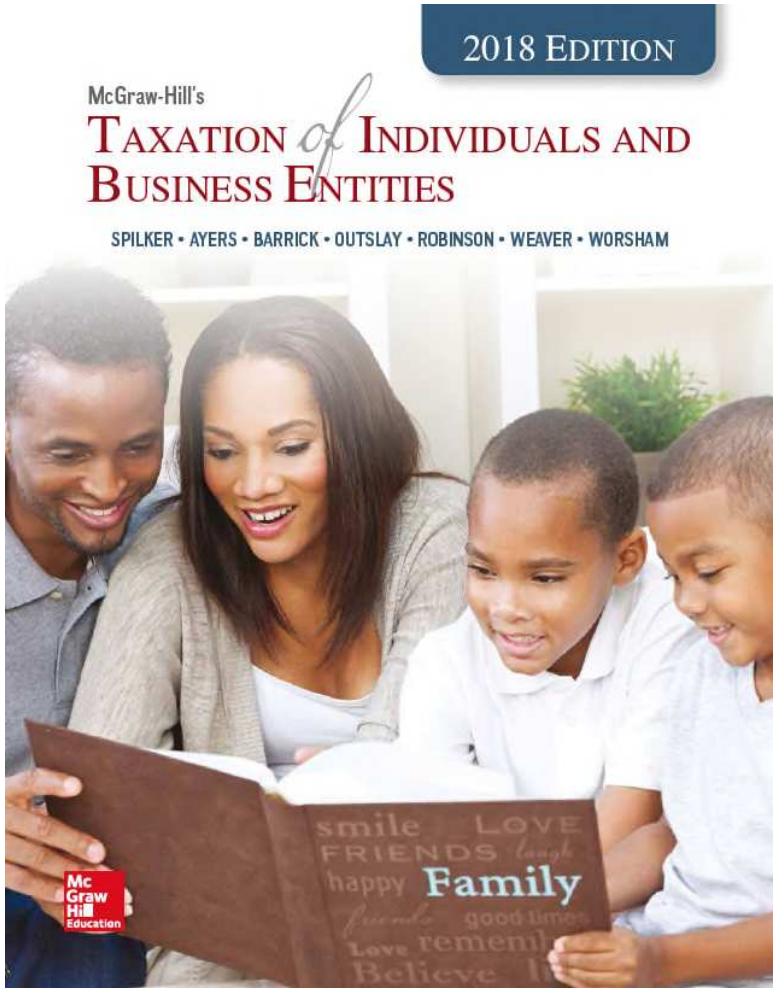

Chapter 2

Tax Compliance, the IRS, and Tax Authorities

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Learning Objectives

1. Identify the filing requirements for income tax returns and the statute of limitations for assessment.
2. Outline the IRS audit process, how returns are selected, the different types of audits, and what happens after the audit.
3. Evaluate the relative weights of the various tax law sources.
4. Describe the legislative process as it pertains to taxation.

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Learning Objectives (Cont.)

5. Perform the basic steps in tax research and evaluate various tax law sources when faced with ambiguous statutes.
6. Describe tax professional responsibilities in providing tax advice.
7. Identify taxpayer and tax professional penalties.

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Taxpayer Filing Requirements

- Corporations: all must file regardless of taxable income
- Estates and Trusts: required to file if gross income exceeds $600
- Individuals: filing is determined by taxpayer's filing status, age, and gross income

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2017 Gross Income Thresholds by Filing Status

EXHIBIT 2-1 **2017 Gross Income Thresholds by Filing Status**

Filing Status and Age (in 2017)	2017 Gross Income	Explanation
Single	$10,400	$6,350 standard deduction + $4,050 personal exemption
Single, 65 or older	$11,950	$6,350 standard deduction + $1,550 additional deduction + $4,050 personal exemption
Married, filing a joint return	$20,800	$12,700 standard deduction + $8,100 personal exemptions (2)
Married, filing a joint return, one spouse 65 or older	$22,050	$12,700 standard deduction + $1,250 additional deduction (2) + $8,100 personal exemptions (2)
Married, filing a joint return, both spouses 65 or older	$23,300	$12,700 standard deduction + $2,500 additional deductions (2) + $8,100 personal exemptions (2)
Married, filing a separate return	$ 4,050	$4,050 personal exemption
Head of household	$13,400	$9,350 standard deduction + $4,050 personal exemption
Head of household, 65 or older	$14,950	$9,350 standard deduction + $1,550 additional deduction + $4,050 personal exemption
Surviving spouse with a dependent child	$16,750	$12,700 standard deduction + $4,050 personal exemption
Surviving spouse, 65 or older, with a dependent child	$18,000	$12,700 standard deduction + $1,250 additional deduction + $4,050 personal exemption

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Tax Return Due Date

- **Individuals**: 15th day of 4th month following end of tax year
- **C corporations**: Generally 15th day of the 4th month following end of tax year
- **Partnerships & S corporations**: 15th day of 3rd month following end of tax year
- Due dates on a Saturday, Sunday, or holiday are extended to next business day
- Individuals, corporations, and partnerships are allowed to apply for automatic extensions

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Return Due Date Examples

- Corporation XYZ, Inc. has a tax year which ends on August 31st. When will their tax return be due?

  December 15th

- Assume they filed an extension, when would the tax return be due?

  June 15th

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Statute of Limitations

- Often tax returns are filed with incorrect amounts reported either in the taxpayer's favor or the government's favor
- **Statute of limitations**: the time in which the taxpayer can file an amended return or the IRS can assess a tax deficiency
  - Generally ends **3 years** from the *later* of (1) the date the tax return was actually filed or (2) the tax return's original due date

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Statute of Limitations Example

- Bill and Mercedes file their 2013 federal tax return on September 6, 2014, after receiving an automatic extension to file their return by October 15, 2014. When does the statute of limitations end for their 2013 tax return?
  - **September 6, 2017** (3 years after the later of the actual filing date and the original due date)

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IRS Audit Selection

- In general a taxpayer's return is selected for audit because the IRS believes the tax return has a high probability of being incorrect.
  - IRS uses computer programs to identify tax returns which might have an understated liability.
    - Discriminant Function (DIF) system (scoring system)
    - Document perfection (checks for math errors, etc.)
    - Information matching programs (compares tax return data with other IRS information)

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Types of Audits

- **Correspondence examinations**
  - Most common audit
  - Conducted by mail and are generally limited to 1 or 2 items on the return
- **Office examinations**
  - Second most common audit
  - Conducted in the local IRS office and tends to be broader in scope
- **Field examinations**
  - Least common audit
  - Held at the taxpayer's place of business and can last months to years

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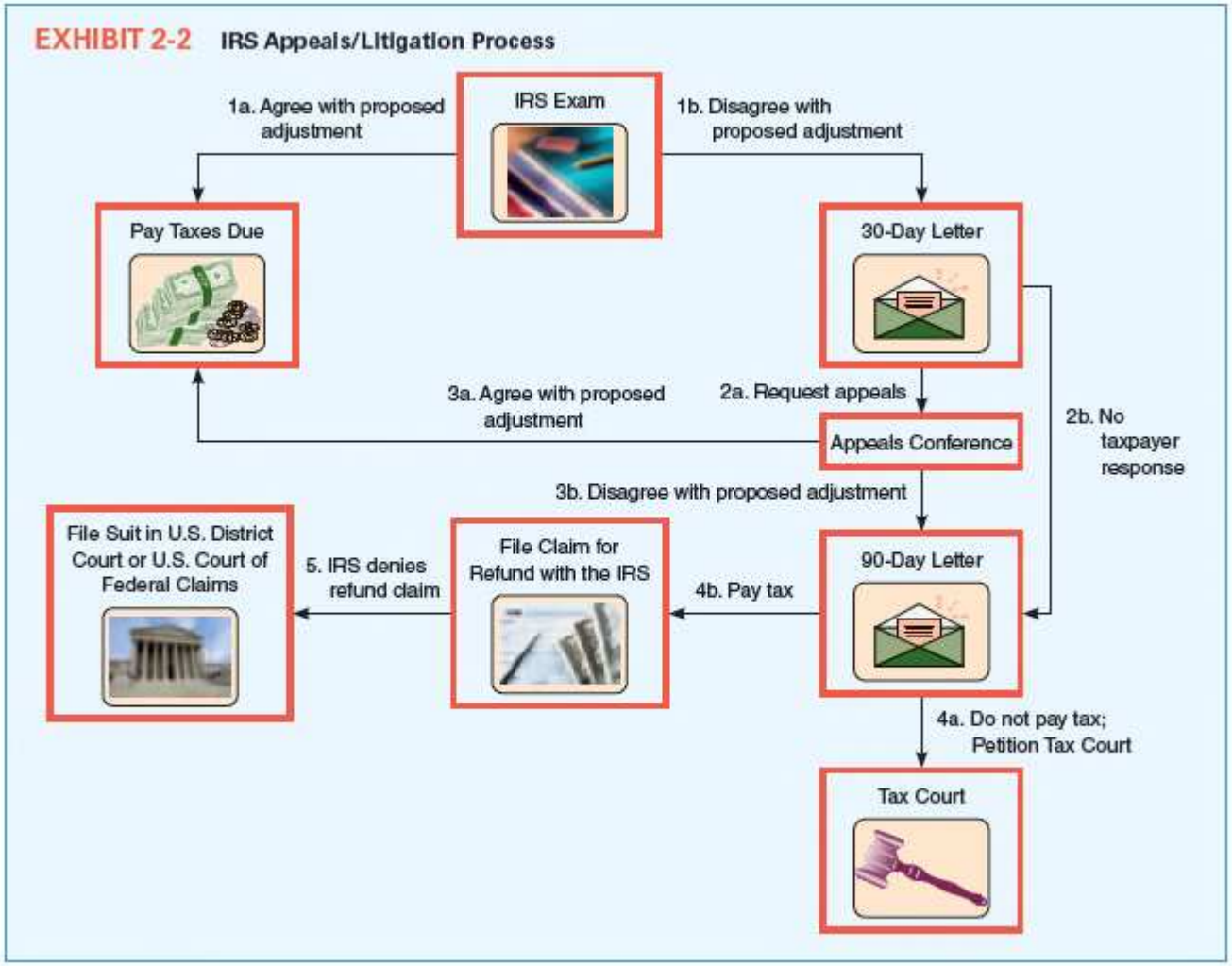
IRS Appeals/Litigation Process



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Trial Level Courts

- U.S. Tax Court
  - National court; Tax experts; Do not pay tax first
- U.S. District Court
  - Local court; Possible jury trial; Generalists; Pay tax first
- U.S. Court of Federal Claims
  - National court; Generalists; Pay tax first; Appeals to U.S. Circuit Court of Appeals for the Federal Circuit

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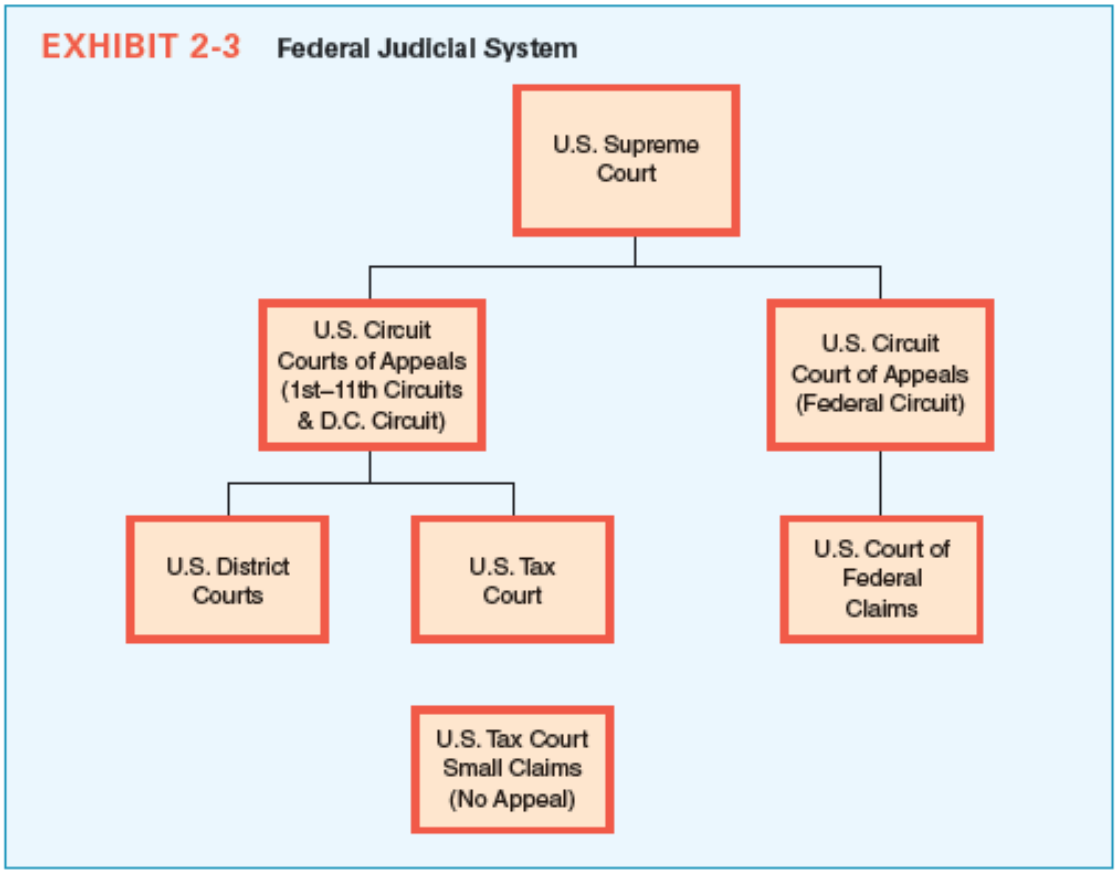
Federal Judicial System



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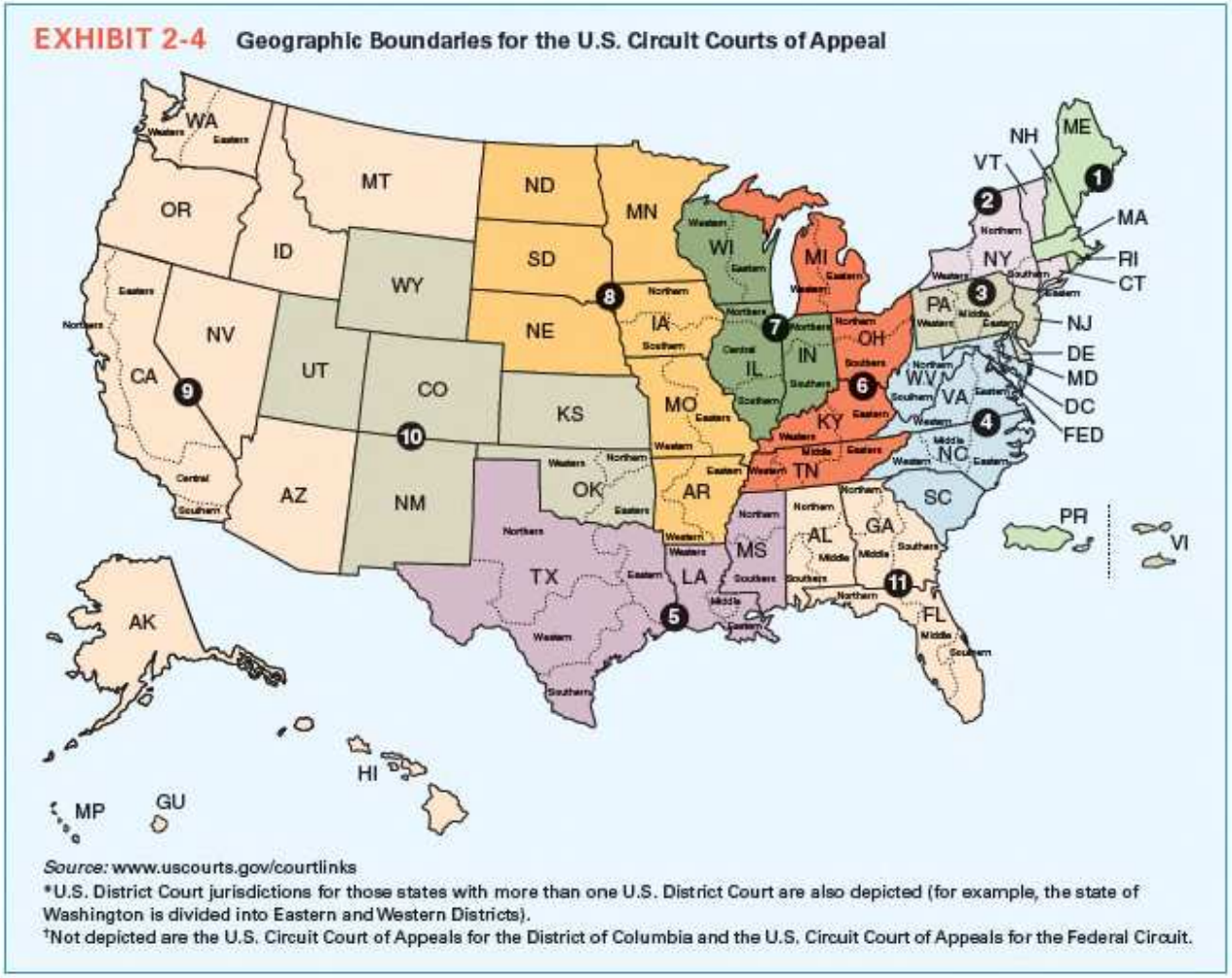
U.S. Circuit Courts of Appeal



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Tax Law Sources

- **Primary Authorities**: Official sources of tax law
  - Statutory sources (e.g., Internal Revenue Code)
  - Judicial sources (the courts)
  - Administrative sources (IRS pronouncements)
- **Secondary Authorities**: Unofficial tax authorities
  - Tax services
  - Tax articles

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Primary Tax Authorities

EXHIBIT 2-5 **Citations to Common Primary Authorities**

Statutory Authorities:	*Citation:*	*Explanation:*
Internal Revenue Code	IRC Sec. 162(e)(2)(B)(i)	Section number 162, subsection e, paragraph 2, subparagraph B, clause i
Committee Reports: Senate Finance Committee Report	S. Rep. No. 353, 82d Cong., 1st Sess. 14 (1951).	Senate report number 353, Congress number 82, Congressional session 1, page number 14, year 1951
House Ways and Means Committee Report	H. Rep. No. 242, 82d Cong., 1st Sess. 40 (1951)	House report number 242, Congress number 82, Congressional session 1, page number 40, year 1951
Administrative Authorities:	***Citation:***	***Explanation:***
Final Regulation	Reg. Sec. 1.217-2(c)(1)	Type of regulation (1 = income tax), code section 217, regulation number 2, paragraph number c, subparagraph number 1
Temporary Regulation	Temp. Reg. Sec. 1.217-2(c)(1)	Same as final regulation
Proposed Regulation	Prop. Reg. Sec. 1.217-2(c)(1)	Same as final regulation
Revenue Ruling	Rev. Rul. 77-262, 1977-2 C.B. 41	Ruling number 77-262 (262nd ruling of 1977), volume number of cumulative bulletin 1977-2, page number 41
Revenue Procedure	Rev. Proc. 99-10, 1999-1 C.B. 272	Procedure number 99-10 (10th procedure of 1999), volume number of cumulative bulletin 1999-1, page number 272
Private Letter Ruling	PLR 200601001	Year 2006, week number 01 (1st week of 2006), ruling number 001 (1st ruling of the week)
Technical Advice Memorandum	TAM 200402001	Year 2004, week number 02 (2nd week of 2004), ruling number 001 (1st ruling of the week)

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Primary Tax Authorities (2)

Judicial Authorities:	*Citation:*	*Explanation:*
U.S. Supreme Court	*Comm. v. Kowalski*, 434 U.S. 77 (S. Ct., 1977)	Volume 434 of the United States Reporter, page 77, year 1977
	Comm. v. Kowalski, 98 S. Ct. 315 (S. Ct., 1977)	Volume 98 of the West court reporter, page 315, year 1977
	Comm. v. Kowalski, 77-2 USTC par. 9,748 (S. Ct., 1977)	Volume 77-2 of the CCH court reporter, paragraph 9,748, year 1977
	Comm. v. Kowalski, 40 AFTR2d 77-6128 (S. Ct., 1977)	Volume 40 of the RIA AFTR2d court reporter, paragraph 77-6128, year 1977
U.S. Circuit Court of Appeals	*Azar Nut Co. v. Comm.*, 931 F.2d 314 (5th Cir., 1991)	Volume 931 of the West F.2d court reporter, page 314, circuit 5th, year 1991
	Azar Nut Co. v. Comm., 91-1 USTC par. 50,257 (5th Cir., 1991)	Volume 91-1 of the CCH USTC court reporter, paragraph 50,257, circuit 5th, year 1991
	Azar Nut Co. v. Comm., 67 AFTR2d 91-987 (5th Cir., 1991)	Volume 67 of the RIA AFTR2d court reporter, paragraph 91-987, year 1991
U.S. Tax Court—Regular decision	*L.A. Beeghly*, 36 TC 154 (1962)	Volume 36 of the Tax Court reporter, page 154, year 1962
U.S. Tax Court—Memorandum decision	*Robert Rodriguez*, RIA TC Memo 2005-012	Paragraph number 2005-012 of the RIA Tax Court Memorandum reporter
	Robert Rodriguez, 85 TCM 1162 (2005)	Volume 85 of the CCH Tax Court Memorandum reporter, page 1162, year 2005
U.S. Court of Federal Claims	*J.R. Cohen v. U.S.*, 510 F. Supp. 297 (Fed. Cl., 1993)	Volume 510 of the West F. Supp. court reporter, page 297, year 1993
	J.R. Cohen v. U.S., 72 AFTR2d 93-5124 (Fed. Cl., 1993)	Volume 72 of the RIA AFTR2d court reporter, paragraph 93-5124, year 1993
	J.R. Cohen v. U.S., 93-1 USTC par. 50,354 (Fed. Cl., 1993)	Volume 93-1 of the CCH USTC court reporter, paragraph 50,354, year 1993
U.S. District Court	*Waxler Towing Co., Inc. v. U.S.*, 510 F. Supp. 297 (W.D, TN, 1981)	Volume 510 of the West F. Supp. court reporter, page 297, Western District (W.D.), state Tennessee, year 1981
	Waxler Towing Co., Inc. v. U.S., 81-2 USTC par. 9,541 (W.D., TN, 1981)	Volume 81-2 of the CCH USTC court reporter, paragraph 9,541, Western District (W.D.), state Tennessee, year 1981
	Waxler Towing Co., Inc. v. U.S., 48 AFTR2d 81-5274 (W.D., TN, 1981)	Volume 48 of the RIA AFTR2d court reporter, paragraph 81-5274, Western District (W.D.), state Tennessee, year 1981

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Secondary Tax Authorities

EXHIBIT 2-6 **Common Secondary Tax Authorities**

Tax Research Services:	***Professional Journals:***
BNA Tax Management Portfolios	*Journal of Accountancy*
CCH Standard Federal Tax Reporter	*Journal of Taxation*
CCH Tax Research Consultant	*Practical Tax Strategies*
RIA Federal Tax Coordinator	*Taxes*
RIA United States Tax Reporter	*Tax Adviser*
Newsletters:	***Quick Reference Sources:***
Daily Tax Report	*IRS Publications*
Federal Tax Weekly Alert	*CCH Master Tax Guide*
Tax Notes	*RIA Federal Tax Handbook*
Law Reviews:	***Textbooks:***
Tax Law Review (New York University School of Law)	*McGraw-Hill's Taxation of Individuals and Business Entities*
Virginia Tax Review (University of Virginia School of Law)	*McGraw-Hill's Essentials of Federal Taxation*

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Tax Sources

- Are the following **primary** or **secondary** sources?
  - Internal Revenue Code
    - (Primary)
  - Tax Article in *USA Today*
    - (Secondary)
  - Article on Supreme Court Opinion
    - (Secondary)
  - Supreme Court Opinion
    - (Primary)
  - RIA Federal Tax Coordinator
    - (Secondary)
  - Treasury Regulations
    - (Primary)

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Statutory Authorities

- **U.S. Constitution**
  - The 16th Amendment provides Congress the ability to tax income directly, from whatever source derived, without apportionment across the states
- **Tax Treaties**
  - Agreements negotiated between countries that describe the tax treatment of entities subject to tax in both countries

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Statutory Authority: Internal Revenue Code

- The main statutory authority
- Changes enacted by Congress
- Organization of Internal Revenue Code:

Subtitle A – Income Taxes

Chapter 1 – Income Taxes

Subchapter A – Determination of Tax Liability

Part I – Definition of Gross Income, Adjusted Gross Income, Taxable Income, etc. (Sec. 61 – 68)

Sec. 61 – Gross Income Defined

Sec. 62 – Adjusted Gross Income Defined

Sec. 63 – Taxable Income Defined

Subsection 63(c) – Standard Deduction

Paragraph 63(c)(2) – Basic Standard Deduction

Subparagraph 63(c)(2)(A) - …

Clause 63(c)(2)(A)(i) - …

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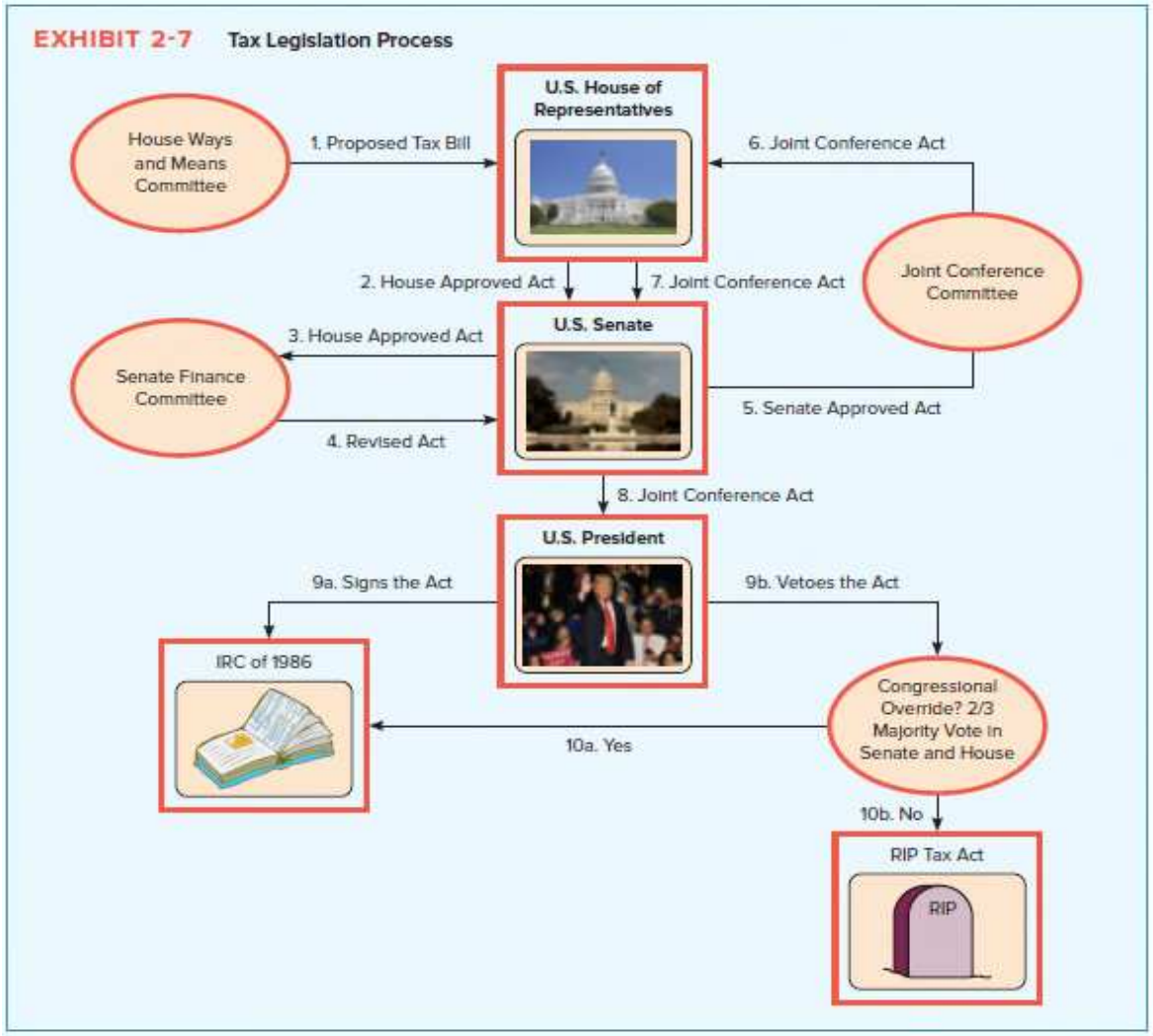
Tax Legislation Process



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Judicial Sources: The Courts

- Tasked with the ultimate authority to interpret the Internal Revenue Code and settle disputes between taxpayers and the IRS
- **Supreme Court:** the highest judicial authority; same authority level as the Internal Revenue Code
- **Courts of Appeals:** 13 circuit courts; the next level of judicial authority

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Judicial Sources: The Courts (2)

- **Trial-level courts:**
  - **U.S. District Courts**
  - **U.S. Court of Federal Claims**
  - **U.S. Tax Court**
- All courts apply the judicial doctrine of ***stare decisis***, which means that a court will rule consistently with its previous rulings and the rulings of higher courts with appellate jurisdiction. The tax court applies the **Golsen rule**.

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Administrative Sources: The U.S. Treasury

- **Regulations**: Treasury Department's official interpretation of the Internal Revenue Code
- **3 Different Forms:**
  - Final
  - Temporary
  - Proposed
- **3 Different Purposes:**
  - Interpretative
  - Procedural
  - Legislative

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Administrative Sources: The U.S. Treasury (2)

- **Revenue Rulings**: Less authoritative weight, but they provide a much more detailed interpretation of the Code (e.g., application to a specific factual situation)
- **Revenue Procedures**: Explain in great detail IRS practice and procedures in administering tax law
- **Letter Rulings**: Less authoritative but more specific than revenue rulings and regulations (e.g., applied to a specific taxpayer)

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Tax Research

- Step 1: Understand facts
- Step 2: Identify issues
- Step 3: Locate relevant authorities
- Step 4: Analyze tax authorities
- Step 5: Document and communicate the results

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Tax Research (2)

- Two types of tax services used in tax research
  - **Annotated**
  - **Topical**
- Research questions often consist of **questions of fact** or **questions of law**
  - The answer to a question of fact hinges upon the facts and circumstances of the taxpayer's transaction
  - The answer to a question of law hinges upon the interpretation of the law, such as interpreting a particular phrase in a code section

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Tax Research (3)

- When the researcher identifies that different authorities have ***conflicting*** views, she should evaluate the "**hierarchy**," **jurisdiction**, and **age** of the authorities
- Once the tax researcher has identified relevant authorities, she must make sure that the authorities are still valid and up to date

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Tax Memo Layout

- Facts
- Issues
- Authorities
- Conclusion
- Analysis

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Client Letter Layout

- Salutation and social graces
- Research question and limitations
- Facts
- Analysis
- Closing

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Tax Professional Responsibilities

- Tax professionals are subject to various statutes, rules, and codes of conduct
  - AICPA Code of Professional Conduct
  - AICPA Statements on Standards for Tax Services
  - IRS's Circular 230
  - State board of accountancy statutes

- Failure to comply with statutes can result in being admonished, suspended, or barred from practicing

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Taxpayer and Tax Practitioner Penalties

- **Civil Penalties**: most common type of penalties
  - Generally in monetary penalties
  - Imposed when tax practitioners or taxpayers violate tax statutes without reasonable cause
- **Criminal Penalties**: much less common than civil penalties
  - Penalties are much higher and can include prison sentences

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Taxpayer and Tax Practitioner Penalties (2)

- A **taxpayer** and **tax practitioner** will not be subject to an underpayment penalty if:
  - There is ***substantial authority*** that supports the tax return position **or**
  - There is a **reasonable basis** for the position and it is **disclosed** on the taxpayer's **tax return**

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