

## Chapter 11 Summary of End-of Chapter Problem Revisions

2014 Edition Problem Number	2013 Edition Problem Number	2014 Edition Modification
1	1	Solution updated
2	2	Solution updated
3	3	
4	4	
5	5	Solution updated
6	6	
7	7	
8	8	
9	9	Solution updated
10	10	
11	11	Solution updated
12	12	Solution modified
13	13	
14	14	
15	15	
16	16	Solution modified
17	17	
18	18	
19	19	
20	20	Solution updated
21	21	Solution updated
22	22	Problem updated
23	23	Problem updated
24	24	Solution updated
25	25	Problem updated
26	26	Problem modified
27	27	Problem modified
28	28	Problem updated
29	29	
30	30	
31	31	
32	32	Problem modified
33	33	Problem modified
34	34	
35	35	Problem updated
36	36	Problem modified
37	37	
38	38	Problem updated
39	39	Problem modified
40	40	Problem updated
41	41	Solution updated

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42	42	Problem modified
43		New problem
44		New problem
45		New problem
46	43	Problem modified
47	44	
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49	46	
50	47	
51	48	
52	49	
53	50	
54	51	
55	52	
56	53	
57	54	
58	55	
59	56	
60	57	
61	58	
62	59	Problem modified
63	60	Problem modified
64	61	
65	62	
66	63	Form updated
67	64	Problem modified
68	65	Solution updated
69	66	
70	67	Solution updated
71	68	Solution updated
72	69	Solution updated
73	70	Solution updated
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## Solutions to Chapter 11 Problem Assignments

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### Check Your Understanding

#### 1. *Deductions for AGI*

**Solution:** Educator expenses: Kindergarten through 12th grade teachers are permitted to deduct up to \$250 of unreimbursed expenses for books, supplies, computer equipment, software, and other supplementary materials used in the classroom.

Tuition and fees: A \$4,000 deduction is allowed for higher-education expenses for taxpayers whose AGI does not exceed \$65,000 (single filers) or \$130,000 (married filing jointly). Single taxpayers with incomes between \$65,000 and \$80,000 (between \$130,000 and \$160,000 for joint filers) are allowed to deduct \$2,000 of qualifying expenses.

Student loan interest: Taxpayers can deduct up to \$2,500 of qualified student loan interest; the deduction is phased out proportionately as AGI increases from \$60,000 to \$75,000 (single filers) or \$125,000 to \$155,000 (married filing jointly).

Health savings accounts: Taxpayers with high-deductible medical insurance plans (at least \$1,250 for individual coverage or \$2,500 for family coverage) can take a deduction for contributions to an HSA for up to \$3,250 for individual coverage and \$6,450 for family coverage in 2013.

Penalty on early withdrawals of savings: Taxpayers assessed a penalty for premature withdrawals from certificates of deposits or other savings accounts can deduct this penalty for AGI to ensure that only the net interest income is included in taxable income.

Other deductions for AGI include deductions for certain business expenses of reservists, performing artists, and government officials, moving expenses, the employer's portion of self-employment tax, self-employed health insurance, IRA and certain other pension plan contributions, alimony paid, and the domestic production activities deduction.

#### 2. *Adjusted Gross Income*

**Solution:** Adjusted gross income (AGI) is a subtotal unique to individuals. It is used to limit the amount that is deductible for some items and as a threshold that must be exceeded before any deduction is allowed for other items. For example, charitable contributions are limited to 50 percent of AGI but medical expenses are deductible only to the extent they exceed 10 percent of AGI (7.5 percent if age 65 or older). It is also the determining factor in the phaseout of a number of otherwise deductible items.

#### 3. *Filing Status*

**Solution:** An unmarried taxpayer can file as head of household if he or she maintains a home for a qualifying relative; otherwise an unmarried individual files as single.

Married taxpayers can file joint returns or file separate returns. A surviving spouse (qualifying widow or widower who has not remarried) can claim the standard deduction for married filing jointly and may use the joint tax rate schedule for up to two years after a spouse's death if there is a qualifying dependent child in the

household. After that, the widow or widower would file as head of household (with a qualifying child) or single. Usually, a taxpayer must be unmarried to file as head of household but a qualifying abandoned spouse may also use this filing status.

#### 4. *Head of Household*

**Solution:** There are two requirements to qualify as head of household: (1) The individual must be single at the end of the year, unless qualifying as an abandoned spouse. (2) The taxpayer must pay more than half the cost of maintaining a home in which a qualifying child (regardless of dependency status) or other relative claimed as a dependent lives for more than half the tax year. A dependent parent does not have to live with the taxpayer.

#### 5. *Exemptions*

**Solution:** Each self-supporting taxpayer is allowed to claim a personal exemption for himself or herself. Dependents are not allowed to claim personal exemptions. Instead, the taxpayer providing the requisite support for the dependent is allowed to claim a dependency exemption. The deductible amount for each exemption is \$3,900 in 2013.

#### 6. *Abandoned Spouse*

**Solution:** This provision provides relief by permitting a qualifying taxpayer to file as head of household instead of married filing separately, the filing status with the harshest tax rate schedule. A qualifying taxpayer is one who is married at year-end but who has not lived with his or her spouse at any time during the last six months of the tax year, and has one or more dependent children living with him or her.

#### 7. *Dependents*

**Solution:** Qualifying relatives include:

- ◆ Parents, grandparents, and other direct ancestors
- ◆ Children, grandchildren, and other lineal descendants
- ◆ Sisters and brothers
- ◆ Aunts and uncles (sisters and brothers of the taxpayer's parents)
- ◆ Nieces and nephews (children of brothers and sisters)
- ◆ In-laws including brothers and sisters-in-law, sons-in-law, daughters-in-law, brothers-in-law, and fathers-in-law.

Only nieces, nephews, aunts, and uncles by blood are qualifying relatives. Cousins are not qualifying relatives.

#### 8. *Multiple Support Agreement*

**Solution:** A multiple support agreement prevents a dependency exemption from being lost by allowing one of the group of support providers to claim the dependency exemption for a qualifying relative as long as that person provides more than 10 percent of the support of the dependent, the group as a whole provides more than 50 percent of the dependent's support, and the other members of the group who provide more than 10 percent of the support agree to grant the exemption to that person.

### 9. *Gross Income Test*

**Solution:** To qualify as a dependent, the dependent's gross income that is subject to taxation must be less than the exemption amount for the year (\$3,900 for 2013). The gross income test is waived for the qualifying child of a taxpayer. A qualifying child must satisfy four tests: (1) be the taxpayer's son, daughter, brother, sister, or descendant of any of these individuals; (2) be under age 19 (or under age 24 if a full-time student) or be totally and permanently disabled; (3) have the same principal place of abode as the taxpayer for more than one-half of the year; and (4) not provide more than one-half of his or her own support.

### 10. *Itemized Deductions*

**Solution:** A taxpayer would itemize his or her deductions when the total deductible amount exceeds the standard deduction. If spouses file separate returns and one spouse itemizes deductions, the other spouse must also itemize.

### 11. *Itemized Deductions*

**Solution:** Following are the floors, all of which are a percentage of adjusted gross income:

- ◆ Medical expenses must exceed 10 percent of AGI (7.5 percent if age 65 or older)
- ◆ Casualty and theft losses must exceed 10 percent of AGI
- ◆ Miscellaneous itemized deductions must exceed 2 percent of AGI.

### 12. *Qualified Residence Interest*

**Solution:** Qualified residence interest is debt secured by the taxpayer's residence to acquire, construct, or substantially improve such residence (acquisition indebtedness). Interest on debt principal up to \$1 million is deductible as an itemized deduction. A taxpayer may combine acquisition indebtedness on no more than two homes to reach the \$1 million debt principal limit. If the second residence is rented out for part of the year, then the taxpayer's personal use of it must exceed the greater of 14 days or 10 percent of the rental days for any of the interest expense to qualify as acquisition debt. Any interest paid on debt principal in excess of \$1 million is not deductible and cannot be carried forward.

Qualified residence interest also includes interest on a home equity loan of up to \$100,000 and is deductible regardless of the use to which the loan proceeds are put (and can include the interest on additional acquisition debt of up to \$100,000 on a home in which the borrower has at least the loan amount as equity). The equity in an individual's qualified residence is the difference between its fair market value and the amount of mortgage debt associated with the residence.

### 13. *Charitable Contribution Limit*

**Solution:** The overall ceiling limit on charitable contributions is 50 percent of adjusted gross income. Excess contributions can be carried forward for up to five years.

### 14. *Charitable Contributions*

**Solution:** Collin should sell the stock and recognize the \$7,500 loss  $[(\$40 - \$100) \times 125 \text{ shares}]$ . He can then contribute the \$5,000 proceeds from the sale to the charity.

This way he preserves the tax benefit of the loss. If he contributes the stock, he will get a contribution deduction of \$5,000 and no tax benefit from the stock's decline in value.

#### 15. *Net Operating Loss*

**Solution:** If an individual's deductions exceed his or her income, a negative taxable income does not necessarily mean that the individual has a net operating loss (NOL). Individuals must make several adjustments to arrive at a potential NOL because an NOL can only result from business losses, such as losses from a sole proprietorship, partnership, or an S corporation. Additionally, employee wages and salary are considered business income and will effectively reduce any other business losses in determining the NOL. In computing an NOL, individuals cannot deduct any personal or dependency exemptions, nonbusiness capital losses can only offset nonbusiness capital gains (excess nonbusiness capital losses cannot increase an NOL), and nonbusiness deductions (most itemized deductions) can only offset nonbusiness income (such as interest and dividends).

#### 16. *Credit vs. Deduction*

**Solution:** A credit is a direct dollar-for-dollar reduction in the tax liability and generates a tax reduction that is independent of the taxpayer's marginal tax rate. The value of a deduction is dependent upon the taxpayer's marginal tax rate. For example, a \$100 credit saves \$100 in tax dollars. A \$100 deduction saves a taxpayer in the 28 percent marginal tax bracket \$28 ( $\$100 \times 28\%$ ) in taxes and saves a taxpayer in the 15 percent marginal tax bracket only \$15 ( $\$100 \times 15\%$ ) in taxes.

#### 17. *Refundable vs. Nonrefundable Credit*

**Solution:** A refundable credit will result in a refund to the taxpayer if the credit is greater than the taxpayer's income tax liability. A nonrefundable credit can only offset the current tax liability, reducing it to zero; any credit in excess of the tax liability is lost. Most tax credits are nonrefundable. The earned income credit is one of the few refundable credits and all or part of the child tax credit may be refundable based on the taxpayer's earned income or social security taxes paid. The health coverage tax credit is also refundable for certain individuals who lost jobs as a result of increased imports and retirees whose pensions were taken over by the Pension Benefit Guaranty Corporation. Nonrefundable credits include the education credits, the child and dependent care credit, and credits to encourage energy efficiency.

#### 18. *AMT*

**Solution:** As originally drafted, the AMT was designed to ensure that all high-income taxpayers would pay some tax by reducing their deductions and increasing their incomes for certain items not included in regular taxable income. The lower AMT rate was then applied to this broadened concept of taxable income. Due to the failure to index any of the AMT provisions (while numerous regular income tax provisions are indexed) prior to 2012, a number of taxpayers who would not have been necessarily considered high income, but who had a large number of dependents or other deductions disallowed when computing the AMT, became

subject to the tax. In 2012 the exemption amount was increased rather than being allowed to revert to its previous smaller amount and was to be indexed for inflation in future years.

### Crunch the Numbers

#### 19. *Student Loan Interest*

**Solution:** Her deduction is \$2,083.25

$\$130,000 \text{ AGI} - \$125,000 \text{ threshold} = \$5,000 \text{ excess}$

$\$5,000 \text{ excess} / \$30,000 \text{ phase out range} = 16.67\% \text{ phase out}$

$\$2,500 \text{ maximum} - (\$2,500 \times 16.67\% \text{ phase out}) = \$2,083.25$

#### 20. *Health Savings Accounts*

**Solution:** \$3,250 and \$5,850. The maximum Ashley can contribute to an HSA for 2013 is \$3,250 (\$4,250 if age 55 or older).

She can deduct the \$3,250 for AGI if contributed to an HSA. She can also deduct the \$2,600 medical insurance premium for AGI as she is self-employed as a sole proprietor;  $\$3,250 + \$2,600 = \$5,850$  deductible.

#### 21. *Dependency Exemptions*

**Solution:** One. Miriam's taxable income (\$4,000) is above the allowable \$3,900 limit so she does not pass the gross income test. Mike is a qualifying child so he qualifies as a dependent.

#### 22. *Standard Deduction*

**Solution:** \$17,000.  $\$12,200 \text{ basic standard deduction} + \$4,800 (4 \times \$1,200) \text{ additional for age and blindness}$ .

#### 23. *Standard Deduction*

**Solution:** \$10,450.  $\$8,950 \text{ basic for head of household} + \$1,500 \text{ additional for age}$ .

#### 24. *Dependent's Taxable Income*

**Solution:** \$450.  $\$2,500 \text{ wages} + \$800 \text{ dividend income} = \$3,300 \text{ AGI} - \$2,850 \text{ standard deduction} = \$450 \text{ taxable income}$ .

A dependent's standard deduction is the greater of \$1,000 or earned income (\$2,500) plus \$350. No personal exemption is allowed.

#### 25. *Taxable Income*

**Solution:** \$80,000.  $\$90,000 \text{ AGI} - \$6,100 \text{ standard deduction} - \$3,900 \text{ personal exemption}$ .

#### 26. *Phaseout of Personal and Dependency Exemptions*

**Solution:** a. \$11,310. Their exemptions before phaseout are \$19,500 ( $\$3,900 \times 5$ ).

$(\$350,500 - \$300,000) / \$2,500 = 20.2$  (round up to next whole number) = 21

$21 \times 2 = 42\% \text{ phaseout percentage}$

$42\% \times \$19,500 = \$8,190 \text{ reduction}$

$\$19,500 - \$8,190 = \$11,310 \text{ deductible}$

b. \$702. His exemption before phaseout is \$3,900 for one personal exemption.  
 $(\$350,500 - \$250,000)/\$2,500 = 40.2$  (round up to next whole number) = 41  
 $41 \times 2 = 82\%$  phaseout percentage  
 $82\% \times \$3,900 = \$3,198$  reduction  
 $\$3,900 - \$3,198 = \$702$  deductible

Note that the phaseout factor is always rounded up to the next whole number because the phaseout applies to each increment of \$2,500 “or fraction thereof.”

### 27. Medical Expense Deduction

**Solution:** \$2,000 if age 45 and \$4,250 if age 70.

$\$14,000 - \$3,000$  reimbursement –  $(10\% \times \$90,000)$  floor = \$2,000.

$\$14,000 - \$3,000$  reimbursement –  $(7.5\% \times \$90,000)$  floor = \$4,250.

Note that if this is Daniel’s only itemized deduction, he would be better off simply taking the standard deduction.

### 28. Tax Benefit Rule

**Solution:** \$600  $(\$12,800 - \$12,200$  standard deduction) of the \$900 refund is included in income in 2014. If their itemized deductions had been \$13,100 or more, then the entire \$900 refund would be included in income in 2014.

### 29. Investment Interest Expense

**Solution:** a. \$240  $[\$100 + \$300 + \$1,200 - (\$68,000 \times 2\%)]$

b. He can deduct \$5,960  $(\$6,200 - \$240)$  if he elects to forgo the maximum 15 percent rate for his capital gain and dividend income; otherwise, he can only deduct \$4,960  $(\$6,200 - \$1,000 - \$240)$ .

Edward’s deduction for investment interest expense is limited to his net investment income, which is the excess of gross investment income over deductible investment expenses (excluding interest). His deductible investment expense is the lesser of the actual \$400  $(\$100 + \$300)$  of investment expenses or the allowable \$240 miscellaneous expense deduction (as computed above). Edward’s investment income can include long-term capital gains and dividend income only if he elects to forgo the maximum 15 percent tax rate that applies to that type of income. If he makes this election, his taxable income will increase by \$1,000 but his tax will only increase by \$100  $[\$1,000 \times (25\% - 15\%)]$ ; he will, however, be able to deduct \$1,000 more in investment interest, which will save \$250  $(\$1,000 \times 25\%)$  in taxes. His net tax savings is \$150  $(\$250 - \$100)$ , so he should make the election. He will report net investment income of \$5,960  $(\$6,200 - \$240)$  and investment interest expense of \$5,960. If he does not make the election, he can only deduct \$4,960  $(\$5,200 - \$240)$  of investment interest expense.

c. The remaining \$4,040  $(\$10,000 - \$5,960)$  is carried forward (indefinitely) until he has sufficient net investment income in a future year.

### 30. Interest Expense

**Solution:** \$10,000.  $(\$3,000$  points + \$7,000 home mortgage interest). The interest on the car loan is not deductible.



31. *Charitable Contributions*

**Solution:** \$23,900 is Arnold's total deduction as follows:

\$4,000 to State University ( $\$5,000 \times 80\%$ ). Note that the 80% limit applies regardless of the value of the preferred ticket rights.

\$19,500 for stock ( $\$22,000$  fair market value limited to 30% of his  $\$65,000$  AGI)  
\$400 fair market value of clothing

He can carry \$2,500 ( $\$22,000 - \$19,500$ ) from the stock contribution forward (up to 5 years) but deductibility in future years will be limited to 30% of AGI in the year deductible.

32. *Computing Taxable Income with Phaseout of Exemptions and Itemized Deductions*

**Solution:** \$310,959 taxable income.

Itemized deductions:  $[(\$380,500 \text{ AGI} - \$300,000 \text{ threshold}) \times 3\%] = \$2,415$   
phaseout (which is less than all of their deductions subject to the phaseout)

$\$64,000 - \$2,415 = \$61,585$  allowable itemized deductions.

6 exemptions  $\times \$3,900 = \$23,400$  exemptions before phaseout

$(\$380,500 \text{ AGI} - \$300,000) / \$2,500 = 32.2$  (round up to 33)

$33 \times 2 = 66\%$  phaseout percentage

$66\% \times \$23,400 = \$15,444$  reduction

$\$23,400 - \$15,444 = \$7,956$  deductible exemptions

$\$380,500 \text{ AGI} - \$61,585 \text{ itemized deductions} - \$7,956 \text{ exemptions} = \$310,959$   
taxable income.

Note that the phaseout factor for exemptions is always rounded up to the next whole number because the phaseout applies to each increment of \$2,500 "or fraction thereof."

33. *Computing an NOL*

**Solution:** \$9,000.  $\$11,000 \text{ salary} + \$2,000 \text{ interest income} - \$20,000 \text{ S corporation loss} =$   
 $(\$7,000) \text{ AGI} - \$7,300 \text{ itemized deductions} - \$3,900 \text{ personal exemption} =$   
 $(\$18,200) \text{ taxable income.}$

To compute her NOL the personal exemption and excess of itemized deductions over the \$2,000 nonbusiness income must be added back.  $(\$18,200) \text{ taxable income} + \$3,900 \text{ personal exemption} + \$5,300 \text{ excess of itemized deductions over interest income} = (\$9,000) \text{ NOL.}$

The NOL could also be computed as  $\$11,000 \text{ salary} - \$20,000 \text{ S corporation loss} = (\$9,000) \text{ NOL.}$

34. *Child Tax Credit*

**Solution:** \$2,750 ( $\$3,000 - \$250$ )

$\$1,000 \times 3 \text{ children} = \$3,000$  before phaseout

$[(\$80,000 \text{ AGI} - \$75,000) / \$1,000 \times \$50] = \$250$  reduction

35. *Education Credits*

**Solution:** \$6,200 in total credits.  $2 \times [(100\% \times \$2,000) + (25\% \times \$2,000)] = \$5,000$  as both sons are eligible for the full \$2,500 American Opportunity Credit in 2013. The daughter is eligible for a \$1,200 ( $20\% \times \$6,000$ ) lifetime learning credit.

36. *Education Credits*

**Solution:** \$1,800 allowed credit

20% x \$10,000 maximum = \$2,000 credit before phaseout

\$54,000 - \$53,000 = \$1,000 excess AGI

\$1,000 excess/\$10,000 phaseout range = 10% reduction

\$2,000 - (\$2,000 x 10% reduction) = \$1,800

37. *Dependent Care Credit*

**Solution:** a. \$600 (20% x \$3,000 one-child maximum)

b. \$400 (20% x \$2,000)

38. *Excess Payroll Tax Withheld*

**Solution:** \$638.60.

Payroll tax withheld (\$3,060 + \$6,426)		\$9,486.00
Total wages (\$40,000 + \$84,000 = \$124,000)		
\$124,000 x 1.45% Medicare tax	\$1,798.00	
\$113,700 Social Security ceiling x 6.2%	<u>7,049.40</u>	<u>8,847.40</u>
Credit for excess withholding		\$ 638.60

39. *First-Time Home Buyer Credit*

**Solution:** a. Juan and Celina must repay the entire \$8,000 credit (which is less than the \$10,000 gain realized on the sale) along with their 2013 tax return since they failed to meet the three-year ownership period.

b. Juan and Celina would have to repay \$6,000 in 2013. Effectively they received a \$7,500 (maximum credit for 2008) interest free loan that they would have had to start repaying in 2010 at the rate of \$500 per year (\$7,500/15 years). When sold in 2013, they would still have \$6,000 (\$7,500 - \$500 recaptured in 2010 - \$500 recaptured in 2011 - \$500 recaptured in 2012) to repay with their 2013 tax return as their gain on the sale of the home exceeds the amount remaining on this loan.

40. *Filing Requirements*

**Solution:** a. Carolyn is not required to file. \$6,100 standard deduction + \$1,500 extra for age + \$3,900 personal exemption = \$11,500 which is more than her gross income subject to tax of \$5,000 (\$2,000 + \$3,000).

b. Tim is required to file. \$2,000 earned income + \$400 interest income = \$2,400 gross income. No personal exemption is allowed for a dependent. He is required to file because his \$2,400 income exceeds his allowable standard deduction of \$2,350 (\$2,000 earned income + \$350).

c. Justin is not required to file. \$6,100 standard deduction + \$3,900 personal exemption = \$10,000 which is more than his gross income of \$8,750. He would have to file, however, to receive a refund of any income tax that was withheld from his pay.

41. *AMT*

**Solution:** a. Tentative minimum tax = \$94,500  $[(\$350,000 \text{ AMTI} - \$175,000) \times 28\% + \$45,500]$   
 b. AMT = \$37,769. Regular tax = \$56,731  $[(\$220,000 - \$183,250) \times 33\% + \$44,603.20]$ . AMT = \$37,769 (\$94,500 tentative minimum tax - \$56,731 regular tax).

42. *Compare Regular and AMT Itemized Deductions*

**Solution:** a. \$59,200. Total itemized expenses =  $[\$14,000 - (\$280,000 \times 10\%) = 0 \text{ medical expenses}] + \$25,000 \text{ home acquisition loan interest} + \$6,000 \text{ home equity loan interest} + \$18,000 \text{ taxes} + \$7,000 \text{ charitable contributions} + [\$8,800 - (\$280,000 \times 2\%) = \$3,200 \text{ misc. itemized deductions}] = \$59,200 \text{ total itemized deductions.}$   
 b. \$32,000 (\$25,000 home acquisition loan interest + \$7,000 charitable contributions). Medical expenses must exceed 10% of AGI so none are deductible for AMT. Interest on home equity loans, taxes, and miscellaneous itemized deductions are not deductible when computing AMT.

43. *Compute Medicare Surtaxes*

**Solution:** \$6,450. They will pay a Medicare surtax on wages of \$360  $[(\$270,000 + \$380,000) - \$250,000 \text{ threshold}] \times 0.9\% = \$3,600$ . They will also pay a 3.8% Medicare surtax on the lesser (a) their \$75,000 net investment income  $(\$59,000 + \$9,000 + \$7,000)$  or (b) \$475,000 AGI in excess of the threshold  $[(\$270,000 + \$380,000 + \$59,000 - \$9,000 + \$7,000 = \$725,000 \text{ AGI}) - \$250,000 \text{ threshold}]$ .  $\$75,000 \text{ NII} \times 3.8\% = \$2,850$ . Their total Medicare surtaxes = \$6,450 (\$3,600 + \$2,850). Note that interest from tax-exempt sources is not subject to the NII surtax.

44. *Compute Medicare Surtaxes*

**Solution:** \$1,686. He will pay a Medicare surtax on his self-employment income of \$90  $[(\$210,000 - \$200,000 \text{ threshold}) \times 0.9\% = \$90]$ . He will also pay a 3.8% Medicare surtax on the lesser (a) his \$42,000 net investment income  $(\$30,000 + \$8,000 + \$7,000 - \$3,000)$  or (b) \$45,184 AGI in excess of the threshold  $[(\$210,000 + \$30,000 + \$8,000 + \$7,000 - \$9,816 \text{ self-employment tax deduction} = \$245,184 \text{ AGI}) - \$200,000 \text{ threshold}]$ .  $\$42,000 \text{ NII} \times 3.8\% = \$1,596$ . His total Medicare surtaxes = \$1,686 (\$90 + \$1,596). The \$9,816 self-employment tax deduction for AGI is computed as follows:  $(\$210,000 \times 92.35\% \times 1.45\% = \$2,812.06) + (\$113,700 \times 6.2\% = \$7,049.40)$ .

45. *Compute Medicare Surtaxes*

**Solution:** \$1,026. She does not owe any Medicare surtax on her salary because it is below the \$200,000 threshold. She will pay a 3.8% Medicare surtax on the lesser (a) her \$29,000 net investment income  $(\$20,000 + \$4,000 + \$5,000)$  or (b) \$27,000 AGI in excess of the threshold  $[(\$198,000 + \$20,000 + \$4,000 + \$5,000 = \$227,000 \text{ AGI}) - \$200,000 \text{ threshold}]$ .  $\$27,000 \times 3.8\% = \$1,026$ . Note that interest from tax-exempt sources is not subject to the NII surtax.

46. *Comprehensive Problem.*

**Solution:** Taxable income = \$47,200; \$2,608 refund is expected.

Salary		\$60,000
Cash dividends		3,000
Interest income on U.S. Treasury bills		4,000
Alimony		2,500
Net rental income		3,500
Short-term capital gain (\$18,000 - \$12,000)	\$6,000	
Long-term capital loss (\$14,000 - \$30,000)	(16,000)	
Net long-term capital loss	(10,000)	
Limit on current capital loss deductions		(3,000)
Adjusted gross income (AGI)		70,000
Less itemized deductions:		
Home mortgage interest	\$6,000	
Property taxes	2,000	
Charitable contributions	7,000	
Less total itemized deductions		(15,000)
Less personal and dependency exemptions (2 x \$3,900)		(7,800)
Taxable income		47,200
Tax on ordinary income (head of household):		
\$1,275 + [15% x (\$44,200 - \$12,750)]	\$5,992.50	
Plus tax on \$3,000 dividend income (\$3,000 x 0%)	0	\$5,992.50
Less child tax credit		(1,000)
Less dependent care credit (\$3,000 maximum x 20%)		(600)
Less income tax withholdings		(7,000)
Tax refund		(\$2,607.50)

Nontaxable income includes: interest income on City of New York bonds, child support, and life insurance proceeds.

She has a \$7,000 capital loss carryforward (\$10,000 net long-term capital loss - \$3,000 limit on current capital loss deduction).

### Think Outside the Text

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

47. *Dependent Care Fringe Benefit vs. Credit*

**Solution:** Factors to be considered include the number of qualifying dependents, the anticipated cost of the childcare and the income level of the taxpayer. The dependent care assistance benefit has a \$5,000 limit regardless of the number of children. The maximum dependent care credit is more for two or more children than for one child and the percentage rate for the credit is higher for lower income taxpayers. Thus, the interaction of the number of dependents, the qualifying expenses and the rate determines which is the most advantageous.

48. *Interest Expense*

**Solution:** Congress needed to eliminate some deductions in 1986 to pay for other tax cuts in the tax bill. It wanted to encourage savings and did not want to encourage

increased personal debt. One way to discourage debt is to eliminate the tax deduction for interest. Note that the interest deduction for residence mortgage was retained because Congress wants to encourage home ownership. For many taxpayers, their homes become their most significant long-term investment.

49. *Deductions for vs. from AGI*

**Solution:** Answers will vary with student.

50. *Deductions for vs. from AGI*

**Solution:** Answers will vary with student.

51. *Proposed New Deduction*

**Suggested Solution:** Some may argue that people with no children view their pets as children. This provision could encourage better care of animals particularly if more funds are spent on medical care. Moreover, a significant amount of research has shown that older persons who have pets are healthier and live longer than those who are alone. This could encourage those persons to acquire a pet and could have the effect of lowering health care costs for older persons. Others may argue that the cost of this proposal would be too expensive and that these funds could be better spent on something else. They could also argue that acquisition of a pet is a purely personal decision and should not be subsidized. The cost for personal assistance animals is already deductible.

## Identify the Issues

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

52. *Abandoned Spouse*

**Solution:** Will Holly qualify as an abandoned spouse?

53. *Dependents*

**Solution:** Will Carla's mother pass the gross income test and qualify as a dependent of Carla? Can Carla qualify as head of household?

54. *Dependents*

**Solution:** If Jose's parents move to Mexico, will they pass the residency test to qualify as dependents of Jose?

55. *Dependents*

**Solution:** Can the student qualify as Jessica's dependent?

56. *Medical Expense Deduction*

**Solution:** Does liposuction qualify as a deductible medical expense?

57. *Medical Expense Deduction*

**Solution:** Does the pool qualify as a medical expense deduction? If yes, how much of the cost can be deducted?

58. *Interest Expense Deduction*

**Solution:** How much can Helen deduct for interest expense for the current year?

59. *Education Credit or Deduction*

**Solution:** How much can they claim for an education tax credit? Are there any alternatives to the education credit? Do the income limitation phaseouts affect their options?

**Develop Research Skills**

Solutions to research problems are included in a separate file.

**Search the Internet**64. *Impairment-Related Work Expenses*

**Solution:** Impairment-related work expenses are the necessary expenses that a taxpayer who is disabled incurs to be able to work. Impairment-related expenses are deductible as business expenses if they are:

1. Necessary for the taxpayer to do his or her work satisfactorily
2. For goods and services not required or used, other than incidentally, in the taxpayer's personal activities, and
3. Not specifically covered under other income tax laws.

Employees report their expenses on Form 2106 (or 2106-EZ). This amount is then entered on Schedule A: *Itemized Deductions* under Other Miscellaneous Deductions. The impairment-related work expenses are not subject to the 2 percent of AGI floor.

65. *Additional Standard Deduction for Blindness.*

**Solution:** If the taxpayer has impaired vision, he or she must get a certified statement from an eye doctor or registered optometrist that the taxpayer:

1. Cannot see better than 20/200 in the better eye with glasses or contact lenses, or
2. The field of vision is not more than 20 degrees.

If the eye condition will never improve beyond these limits, the statement should include this fact and be kept with the taxpayer's records.

If the taxpayer's vision can be corrected beyond these limits only by contact lenses that can be worn only briefly because of pain, infection, or ulcers, the taxpayer can take the additional standard deduction for blindness.

66. *Taxable Income.*

A filled-in Form 1040 for 2012 is included at the end of this file.

**2012 Solution:** Taxable income = \$47,400; \$2,553 refund is expected.

Salary	\$60,000
Cash dividends	3,000
Interest income on U.S. Treasury bills	4,000
Alimony	2,500
Net rental income	3,500
Short-term capital gain (\$18,000 - \$12,000)	\$6,000
Long-term capital loss (\$14,000 - \$30,000)	(16,000)
Net long-term capital loss	(10,000)

Limit on current capital loss deductions		<u>(3,000)</u>
Adjusted gross income (AGI)		70,000
Less itemized deductions:		
Home mortgage interest	\$6,000	
Property taxes	2,000	
Charitable contributions	<u>7,000</u>	
Less total itemized deductions		(15,000)
Less personal and dependency exemptions (2 x \$3,800)		<u>(7,600)</u>
Taxable income		<u>47,400</u>
Tax on ordinary income (head of household):		
\$1,240 + [15% x (\$44,400 - \$12,400)]	\$6,040.00	
Plus tax on \$3,000 dividend income [(\$47,350 - \$44,400) x 0%] + (\$47,400 - \$47,350) x 15%]*	<u>7.50</u>	\$ 6,047.50
Less child tax credit		(1,000)
Less dependent care credit (\$3,000 maximum x 20%)		(600)
Less income tax withholdings		<u>(7,000)</u>
Tax refund		<u>(\$2,552.50)</u>
Nontaxable income includes: interest income on City of New York bonds, child support, and life insurance proceeds.		
*Only the \$50 of \$3,000 dividend income that exceeds the 15% tax bracket is taxed at 15%; the \$2,950 that falls within the 15% bracket escapes taxation.		
She has a \$7,000 capital loss carryforward (\$10,000 net long-term capital loss - \$3,000 limit on current capital loss deduction).		

Tax forms for 2013 have not yet been released by IRS.

**Solution for 2013:** Taxable income = \$47,200; \$2,608 refund is expected.

Salary		\$60,000
Cash dividends		3,000
Interest income on U.S. Treasury bills		4,000
Alimony		2,500
Net rental income		3,500
Short-term capital gain (\$18,000 - \$12,000)	\$6,000	
Long-term capital loss (\$14,000 - \$30,000)	<u>(16,000)</u>	
Net long-term capital loss	(10,000)	
Limit on current capital loss deductions		<u>(3,000)</u>
Adjusted gross income (AGI)		70,000
Less itemized deductions:		
Home mortgage interest	\$6,000	
Property taxes	2,000	
Charitable contributions	<u>7,000</u>	
Less total itemized deductions		(15,000)
Less personal and dependency exemptions (2 x \$3,900)		<u>(7,800)</u>
Taxable income		<u>47,200</u>
Tax on ordinary income (head of household):		
\$1,275 + [15% x (\$44,200 - \$12,750)]	\$5,992.50	
Plus tax on \$3,000 dividend income (\$3,000 x 0%)	<u>0</u>	\$5,992.50

Less child tax credit	(1,000)
Less dependent care credit (\$3,000 maximum x 20%)	(600)
Less income tax withholdings	<u>(7,000)</u>
Tax refund	<u>(\$2,607.50)</u>

Nontaxable income includes: interest income on City of New York bonds, child support, and life insurance proceeds.

She has a \$7,000 capital loss carryforward (\$10,000 net long-term capital loss - \$3,000 limit on current capital loss deduction).

#### 67. *Itemized Deductions.*

**Solution:** \$12,970 total itemized deductions for 2013.

Medical:  $(\$600 + \$4,600 + \$300 + \$900) - (\$60,000 \times 10\%) = \$400$

Taxes:  $\$1,800 + \$3,000 = \$4,800$ .

Interest: \$6,000

Charitable contributions: \$1,400

Miscellaneous:  $(\$1,300 + \$150 + \$120) - (\$60,000 \times 2\%) = \$370$

\$400 medical + \$4,800 taxes + \$6,000 + \$1,400 charitable contributions + \$370 miscellaneous. There is no phaseout because their income is below the \$300,000 threshold.

Forms for 2013 are not yet available.

A filled-in Schedule A for 2012 is included at the end of this file. Note that the total itemized deductions for 2012 would be \$14,470. Deductible medical expenses would be \$1,900 (instead of \$400) because the threshold for 2012 is only 7.5% of AGI (instead of 10% of AGI).

### Develop Planning Skills

#### 68. *After-Tax Interest Rate*

**Solution:** Larry should finance the car through a home equity loan because the after-tax interest rate is only 3.35 percent  $[5\% \times (1 - .33 \text{ tax rate})]$  for the home equity loan compared with 3.5 percent for the loan through the dealer. The home equity loan interest expense is deductible while the car loan interest is not.

#### 69. *Charitable Contributions*

**Solution:** d. Manuel should contribute the cash to get a \$10,000 deduction.

The stock acquired five years ago should be sold so Manuel can deduct the \$3,000 loss; then he could contribute the proceeds from the sale.

The stock acquired six months ago would only generate a contribution deduction of \$4,000 because it has not been held for more than one year.

The inventory would only generate a contribution deduction of \$10,000, so it should be sold and the loss recognized.

#### 70. *Charitable Contributions*

**Solution:** Martin should elect to deduct the \$50,000 basis this year because it allows him to deduct up to 50 percent of AGI in the current year. There will be no carryover to future years, however. Martin would have taxable income of \$44,100 [\$100,000 -



\$3,900 personal exemption – (\$50,000 + \$2,000 real estate taxes). His tax on \$44,100 is \$6,953.75  $[(\$44,100 - \$36,250) \times 25\%] + \$4,991.25$ .

If Martin instead chooses to use the \$60,000 fair market value, his current deduction will be limited to \$30,000 (30% of AGI) with the \$30,000 balance carried forward a maximum of five years, and he will be subject to the same 30 percent of AGI limitation. His taxable income with the \$30,000 deduction is \$64,100  $[\$100,000 - \$3,900 - (\$30,000 + \$2,000)]$ . His tax on \$64,100 is \$11,953.75  $[(\$64,100 - \$36,250) \times 25\%] + \$4,991.25$ , an increase of \$5,000  $(\$11,953.75 - \$6,953.75)$  over the first alternative.

As his expected AGI in the coming years is only \$15,000, he will have a maximum charitable contribution of only \$4,500  $(\$15,000 \times 30\%)$  in each year. Over the five-year carry over period, he would be able to deduct a maximum of only \$22,500  $(5 \times \$4,500)$  and he would lose the remaining \$7,500. In addition, assuming his other itemized deductions remain at \$2,000 and he is not yet 65, he will benefit by no more than \$400  $(\$4,500 + \$2,000 - \$6,100 \text{ standard deduction})$  in any of the future years depending on the standard deduction inflation adjustment. This would amount of an annual tax savings of \$40  $(\$400 \times 10\% \text{ tax rate})$  or a savings of \$200  $(\$40 \times 5)$  over the 5-year carry over period. At 6 percent, the present value of an annual tax savings of \$40 is only \$168.48  $(\$40 \times 4.212)$ . This is \$4,831.53  $(\$5,000 - \$168.48)$  less than the tax savings achieved by deducting the \$50,000 this year. If Martin reaches age 65 during this period, his standard deduction will increase by at least \$1,500, further eroding the benefit of itemizing his deductions to a negative \$1,100  $(\$4,500 + \$2,000 - \$6,100 - \$1,500 \text{ extra standard deduction for age})$  for any year he is 65 and increasing the tax savings of the \$50,000 deduction.

#### 71. *Fringe Benefit vs. Additional Pay*

**Solution:** The \$19,000 job with Mahalo that provides free child care provides the greater after-tax cash flow.

Their current \$75,000 taxable income (after all deductions) will increase to \$94,000  $(\$19,000 + \$75,000)$  if Sharon accepts the job with Mahalo; their taxable income will increase to \$101,000  $(\$26,000 + \$75,000)$  if she accepts the job with Ohana. The 15% tax bracket ends at \$72,500 so all of the additional income from either job will be taxed at a 25% tax rate.

If Sharon takes the job that pays \$7,000 more  $(\$26,000 - \$19,000)$ , she will have to use \$6,300  $(\$525 \times 12 \text{ months})$  in after-tax dollars to pay for her childcare.

She will be subject to additional FICA tax of \$535.50  $(\$7,000 \times 7.65\% \text{ in } 2013)$ . She will have \$1,750  $[(\$7,000 \times 25\%)]$  in income taxes for the additional \$7,000 in income from this job for a net increase in income taxes of \$550  $[\$1,750 - \$1,200 (20\% \times \$6,000) \text{ dependent care credit}]$ .

The additional \$1,085.50  $(\$535.50 \text{ FICA} + \$550 \text{ income tax})$  in total tax leaves her with only \$5,914.50  $(\$7,000 - \$1,085.50 \text{ tax})$  in after-tax cash flow to pay the \$6,300 in child care expenses.

She will be better off by \$385.50 (\$6,300 - \$5,914.50) to take the job with Mahalo for \$19,000 that provides free child care facilities. She should, however, carefully consider whether there would be other reasons to take the higher paying job that outweigh the tax advantages of the one providing child care.

### 72. *Education Tax Credit and Deduction*

**Solution:** The tuition and fees they pay are eligible for the American Opportunity credit (maximum \$2,500 on annual tuition, fees, and course materials of \$4,000 or more) for up to four years of post-secondary education. Lillian would then be eligible for the lifetime learning credit (up to 20 percent of \$10,000 tuition and fees) for the remaining years of her education. The American Opportunity credit phases out proportionately over modified AGIs of \$160,000 - \$180,000 for married taxpayers. The lifetime learning credit phases out proportionately over modified AGIs of \$107,000 - \$127,000 for married taxpayers.

If the credits are not claimed, a \$4,000 deduction is allowed for higher-education expenses for taxpayers whose AGI does not exceed \$130,000 (married filing jointly). Married taxpayers with income between \$130,000 and \$160,000 are allowed to deduct \$2,000 of qualifying expenses.

### 73. *Dependent Care Credit versus FSA*

**Solution:** Using an FSA results in \$1,032.50 more in total tax savings compared to claiming a dependent care credit. Eileen's taxable income before considering the FSA deduction is \$58,250 (\$75,000 - \$7,800 exemptions and \$8,950 standard deduction) and this places her in the 25% tax bracket. Using an FSA effectively allows a deduction of \$5,000 at the 25% tax rate (saving \$1,250) compared to the dependent care credit that allows a deduction equivalent of \$3,000 at a 20% rate (saving only \$600 in taxes) for an income tax savings of \$650. Additionally, using an FSA saves \$382.50 (\$5,000 x 7.65% in 2013) in FICA taxes.

The total tax liability using an FSA would be \$12,170 computed as follows:

\$75,000 salary - \$5,000 to FSA = \$70,000 net salary - \$8,950 standard deduction - \$3,900 personal exemption - \$3,900 dependency exemption = \$53,250 taxable income. The income tax is { \$6,652.50 + [(\$53,250 - \$48,600) x 25%] } = \$7,815 - \$1,000 child tax credit = \$6,815. The FICA tax is \$5,355 (\$70,000 net salary x 7.65% in 2013). The total tax liability is \$12,170 (\$6,815 income tax + \$5,355 FICA tax).

The total tax liability if claiming the dependent care credit is \$13,202.50 computed as follows: \$75,000 salary - \$8,950 standard deduction - \$3,900 personal exemption - \$3,900 dependency exemption = \$58,250 taxable income. The income tax is \$6,652.50 + [(\$58,250 - \$48,600) x 25%] = \$9,065 - \$1,000 child tax credit - \$600 (\$3,000 x 20%) dependent care credit = \$7,465 income tax. The FICA tax is \$5,737.50 (\$75,000 salary x 7.65%). The total tax liability is \$13,202.50 (\$7,465 income tax + \$5,737.50 FICA tax).

\$13,202.50 - \$12,170 = \$1,032.50 tax savings with an FSA

74. *Stock Options and AMT*

**Solution:** Alisa recognizes no income regardless of when she exercises the options. She will however, recognize the appreciation on the stock for regular tax purposes in the year she sells the stock acquired with the ISO. At the time of sale, she will have a long-term capital gain of \$1.7 million  $[(\$100 \text{ selling price} - \$15 \text{ basis}) \times 20,000 \text{ shares}]$  for regular tax purposes.

For AMT purposes, however, Alisa's current year income tax return will show an AMT adjustment of \$500,000  $[(\$40 \text{ fair market value at exercise date} - \$15 \text{ exercise price}) \times 20,000 \text{ shares}]$  if the options are exercised now and an AMT adjustment of \$800,000  $[(\$55 \text{ fair market value at exercise date} - \$15 \text{ exercise price}) \times 20,000 \text{ shares}]$  if the options are exercised later in the year.

When the stock is sold, the basis for AMT purposes will be the fair market value at the time the option was exercised. If she exercises the option when the fair market value is \$40, she will have a \$1.2 million  $[(\$100 - \$40) \times 20,000 \text{ shares}]$  long-term capital gain upon sale for AMT purposes. If she exercises the option when the fair market value is \$55, she will have a \$900,000  $[(\$100 - \$55) \times 20,000 \text{ shares}]$  long-term capital gain upon sale for AMT purposes.

Alisa's AMTI and AMT are significantly lower when she exercises her ISOs at the lower fair market value. Her lower stock value results in a decrease in the AMT adjustment and a corresponding decrease in the AMT due. She trades AMT ordinary income, which is taxed at 26 to 28 percent, for AMT long-term capital gain income, which is generally taxed at a maximum 20 percent (excluding any applicable surtax). She also defers payment of the tax because AMT ordinary income is a current year tax liability while the AMT long-term capital gain tax from the sale is deferred until the year of sale.

For the year Jan. 1–Dec. 31, 2012, or other tax year beginning , 2012, ending , 20

See separate instructions.

Your first name and initial Last name Your social security number

Kelly

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. **▲** 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).

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**

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

Check only one box.

**Exemptions**

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

b ☐ Spouse . . . . .

**c Dependents:**

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

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

**d** Total number of exemptions claimed . . . . .

**Boxes checked on 6a and 6b** 1

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

- lived with you 1
- did not live with you due to divorce or separation (see instructions)

**Dependents on 6c not entered above**

**Add numbers on lines above ▶** 2

**Income**

7 Wages, salaries, tips, etc. Attach Form(s) W-2 . . . . . 60,000

8a **Taxable** interest. Attach Schedule B if required . . . . . 4,000

b **Tax-exempt** interest. Do not include on line 8a . . . . . 5,000 **8b**

9a Ordinary dividends. Attach Schedule B if required . . . . . 3,000

b Qualified dividends . . . . . 3,000 **9b**

10 Taxable refunds, credits, or offsets of state and local income taxes . . . . .

11 Alimony received . . . . . 2,500

12 Business income or (loss). Attach Schedule C or C-EZ . . . . .

13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ☐ (3,000)

14 Other gains or (losses). Attach Form 4797 . . . . .

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 . . . . . 3,500

18 Farm income or (loss). Attach Schedule F . . . . .

19 Unemployment compensation . . . . .

20a Social security benefits **20a** **b** Taxable amount . . . . . **20b**

21 Other income. List type and amount . . . . . **21**

22 Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶ 70,000

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.

Enclose, but do not attach, any payment. Also, please use Form 1040-V.

**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 . . . . . 0 **36**

37 Subtract line 36 from line 22. This is your **adjusted gross income** ▶ 70,000 **37**

**Tax and Credits****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, \$5,950

Married filing jointly or Qualifying widow(er), \$11,900

Head of household, \$8,700

<b>38</b>	Amount from line 37 (adjusted gross income)	<b>38</b>	70,000
<b>39a</b>	Check <input type="checkbox"/> <b>You</b> were born before January 2, 1948, <input type="checkbox"/> <b>Blind.</b> <input type="checkbox"/> <b>Spouse</b> was born before January 2, 1948, <input type="checkbox"/> <b>Blind.</b> <b>Total boxes checked</b> <b>39a</b> <input type="checkbox"/>		
<b>b</b>	If your spouse itemizes on a separate return or you were a dual-status alien, check here <b>39b</b> <input type="checkbox"/>		
<b>40</b>	<b>Itemized deductions</b> (from Schedule A) or your <b>standard deduction</b> (see left margin)	<b>40</b>	15,000
<b>41</b>	Subtract line 40 from line 38	<b>41</b>	55,000
<b>42</b>	<b>Exemptions.</b> Multiply \$3,800 by the number on line 6d	<b>42</b>	7,600
<b>43</b>	<b>Taxable income.</b> Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	<b>43</b>	47,400
<b>44</b>	<b>Tax</b> (see instructions). Check if any from: <b>a</b> <input type="checkbox"/> Form(s) 8814 <b>b</b> <input type="checkbox"/> Form 4972 <b>c</b> <input type="checkbox"/> 962 election	<b>44</b>	6,048
<b>45</b>	<b>Alternative minimum tax</b> (see instructions). Attach Form 6251	<b>45</b>	
<b>46</b>	Add lines 44 and 45	<b>46</b>	6,048
<b>47</b>	Foreign tax credit. Attach Form 1116 if required	<b>47</b>	
<b>48</b>	Credit for child and dependent care expenses. Attach Form 2441	<b>48</b>	600
<b>49</b>	Education credits from Form 8863, line 19	<b>49</b>	
<b>50</b>	Retirement savings contributions credit. Attach Form 8880	<b>50</b>	
<b>51</b>	Child tax credit. Attach Schedule 8812, if required	<b>51</b>	1,000
<b>52</b>	Residential energy credits. Attach Form 5695	<b>52</b>	
<b>53</b>	Other credits from Form: <b>a</b> <input type="checkbox"/> 3800 <b>b</b> <input type="checkbox"/> 8801 <b>c</b> <input type="checkbox"/>	<b>53</b>	
<b>54</b>	Add lines 47 through 53. These are your <b>total credits</b>	<b>54</b>	1,600
<b>55</b>	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0-	<b>55</b>	4,448

**Other Taxes**

<b>56</b>	Self-employment tax. Attach Schedule SE	<b>56</b>	
<b>57</b>	Unreported social security and Medicare tax from Form: <b>a</b> <input type="checkbox"/> 4137 <b>b</b> <input type="checkbox"/> 8919	<b>57</b>	
<b>58</b>	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required	<b>58</b>	
<b>59a</b>	Household employment taxes from Schedule H	<b>59a</b>	
<b>b</b>	First-time homebuyer credit repayment. Attach Form 5405 if required	<b>59b</b>	
<b>60</b>	Other taxes. Enter code(s) from instructions	<b>60</b>	
<b>61</b>	Add lines 55 through 60. This is your <b>total tax</b>	<b>61</b>	4,448

**Payments**

If you have a qualifying child, attach Schedule EIC.

<b>62</b>	Federal income tax withheld from Forms W-2 and 1099	<b>62</b>	7,000
<b>63</b>	2012 estimated tax payments and amount applied from 2011 return	<b>63</b>	
<b>64a</b>	<b>Earned income credit (EIC)</b>	<b>64a</b>	
<b>b</b>	Nontaxable combat pay election <b>64b</b>		
<b>65</b>	Additional child tax credit. Attach Schedule 8812	<b>65</b>	
<b>66</b>	American opportunity credit from Form 8863, line 8	<b>66</b>	
<b>67</b>	Reserved	<b>67</b>	
<b>68</b>	Amount paid with request for extension to file	<b>68</b>	
<b>69</b>	Excess social security and tier 1 RRTA tax withheld	<b>69</b>	
<b>70</b>	Credit for federal tax on fuels. Attach Form 4136	<b>70</b>	
<b>71</b>	Credits from Form: <b>a</b> <input type="checkbox"/> 2439 <b>b</b> <input type="checkbox"/> Reserved <b>c</b> <input type="checkbox"/> 8801 <b>d</b> <input type="checkbox"/> 8885	<b>71</b>	
<b>72</b>	Add lines 62, 63, 64a, and 65 through 71. These are your <b>total payments</b>	<b>72</b>	7,000

**Refund**

Direct deposit? See instructions.

<b>73</b>	If line 72 is more than line 61, subtract line 61 from line 72. This is the amount you <b>overpaid</b>	<b>73</b>	2,552
<b>74a</b>	Amount of line 73 you want <b>refunded to you</b> . If Form 8888 is attached, check here <input type="checkbox"/>	<b>74a</b>	2,552
<b>b</b>	Routing number	<b>c</b>	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings
<b>d</b>	Account number		

**Amount You Owe**

<b>75</b>	Amount of line 73 you want <b>applied to your 2013 estimated tax</b>	<b>75</b>	
<b>76</b>	<b>Amount you owe.</b> Subtract line 72 from line 61. For details on how to pay, see instructions	<b>76</b>	
<b>77</b>	Estimated tax penalty (see instructions)	<b>77</b>	

**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**

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

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

Your signature	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, <b>both</b> must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.) <input type="text"/>

**Paid Preparer Use Only**

Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
Firm's name	Firm's EIN	Phone no.		
Firm's address				

**SCHEDULE A  
(Form 1040)**Department of the Treasury  
Internal Revenue Service (99)

Name(s) shown on Form 1040

## Chapter 11, Problem 67

**Itemized Deductions**► Information about Schedule A and its separate instructions is at [www.irs.gov/form1040](http://www.irs.gov/form1040).

► Attach to Form 1040.

OMB No. 1545-0074

**2012**Attachment  
Sequence No. **07**

Your social security number

Simon and Ellen

**Medical  
and  
Dental  
Expenses****Caution.** Do not include expenses reimbursed or paid by others.

<b>1</b>	Medical and dental expenses (see instructions) . . . . .	<b>1</b>	6,400	
<b>2</b>	Enter amount from Form 1040, line 38 <b>2</b>			
<b>3</b>	Multiply line 2 by 7.5% (.075) . . . . .	<b>3</b>	4,500	
<b>4</b>	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	<b>4</b>	1,900	

**Taxes You  
Paid****5** State and local (**check only one box**):

<b>a</b>	<input checked="" type="checkbox"/> Income taxes, or	<b>5</b>	1,800	
<b>b</b>	<input type="checkbox"/> General sales taxes			

<b>6</b>	Real estate taxes (see instructions) . . . . .	<b>6</b>	3,000	
<b>7</b>	Personal property taxes . . . . .	<b>7</b>		
<b>8</b>	Other taxes. List type and amount ►	<b>8</b>		
<b>9</b>	Add lines 5 through 8 . . . . .	<b>9</b>	4,800	

**Interest  
You Paid****Note.**  
Your mortgage  
interest  
deduction may  
be limited (see  
instructions).

<b>10</b>	Home mortgage interest and points reported to you on Form 1098	<b>10</b>	6,000	
<b>11</b>	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying no., and address ►	<b>11</b>		
<b>12</b>	Points not reported to you on Form 1098. See instructions for special rules . . . . .	<b>12</b>		
<b>13</b>	Mortgage insurance premiums (see instructions) . . . . .	<b>13</b>		
<b>14</b>	Investment interest. Attach Form 4952 if required. (See instructions.)	<b>14</b>		
<b>15</b>	Add lines 10 through 14 . . . . .	<b>15</b>	6,000	

**Gifts to  
Charity**If you made a  
gift and got a  
benefit for it,  
see instructions.

<b>16</b>	Gifts by cash or check. If you made any gift of \$250 or more, see instructions . . . . .	<b>16</b>	1,400	
<b>17</b>	Other than by cash or check. If any gift of \$250 or more, see instructions. You <b>must</b> attach Form 8283 if over \$500 . . . . .	<b>17</b>		
<b>18</b>	Carryover from prior year . . . . .	<b>18</b>		
<b>19</b>	Add lines 16 through 18 . . . . .	<b>19</b>	1,400	

**Casualty and  
Theft Losses**

<b>20</b>	Casualty or theft loss(es). Attach Form 4684. (See instructions.) . . . . .	<b>20</b>		
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**Job Expenses  
and Certain  
Miscellaneous  
Deductions**

<b>21</b>	Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.) ►	<b>21</b>	1,300	
<b>22</b>	Tax preparation fees . . . . .	<b>22</b>	150	
<b>23</b>	Other expenses—investment, safe deposit box, etc. List type and amount ► <u>safe deposit box rental</u>	<b>23</b>	120	
<b>24</b>	Add lines 21 through 23 . . . . .	<b>24</b>	1,570	
<b>25</b>	Enter amount from Form 1040, line 38 <b>25</b>			
<b>26</b>	Multiply line 25 by 2% (.02) . . . . .	<b>26</b>	1,200	
<b>27</b>	Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-	<b>27</b>	370	

**Other  
Miscellaneous  
Deductions**

<b>28</b>	Other—from list in instructions. List type and amount ►	<b>28</b>		
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**Total  
Itemized  
Deductions**

<b>29</b>	Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40 . . . . .	<b>29</b>	14,470	
<b>30</b>	If you elect to itemize deductions even though they are less than your standard deduction, check here . . . . .			<input type="checkbox"/>