Advanced Individual Income Tax

Documents for
Lecture on Chapter 3

Tax Planning Strategies

UNC Charlotte MACC Program

May 21, 2016

Memo from Instructor,

These materials will be used by the instructor when discussing the tax planning concepts in this chapter.

Our chapter learning objectives are:
1. Identify the objectives of basic tax planning strategies.
2. Apply the timing strategy and describe its applications and limitations.
3. Apply the concept of present value to tax planning.
4. Apply the strategy of income shifting, provide examples, and describe its limitations.
5. Apply the conversion strategy, provide examples, and describe its limitations.
6. Describe basic judicial doctrines that limit tax planning strategies.
7. Contrast tax avoidance and tax evasion.

Page 3 contains a chapter outline with a list of textbook examples that relate to topics in the outline. Citations for code sections are provided for some key tax rules related to these planning strategies. There are relatively few citations to the code on page 4. However, we need to be able to demonstrate that our tax planning strategies comply with the tax law, and that requires a detailed analysis of applicable code sections.

Page 4 has some examples that illustrate the use of present value analysis in tax planning.

Page 5 has a "big picture" of how the Internal Revenue Code is organized. This exhibit highlights key groups of rules that are important in an individual income tax course. I encourage you to spend some time looking at this big picture.

You'll notice that the **first 60 or so code sections** cover: (1) tax rates for individuals and corporations, (2) tax credits for such expenditures as childcare, credits from amounts withheld from your pay for income tax, and (3) the alternative minimum tax

Next you see that **approximately 100 code sections** identify income that must be reported on your tax return and income that may be excluded from your tax return. The first 8 of those sections deal with definitions. Those definitions are very important.

The **next 100 or so code sections** deal with deductions. Both individuals and corporations are affected by the first group of deductions. The second group affects individuals and the third group affects only for corporations.

Deductions are limited in many ways and you'll find many of those limits in starting with code sections 261.

Wealth is often accumulated in the form of property. Many investors earn their living from investing in property and selling that property. When you dispose of property with (make a gift, make a sale, trade for other property, etc.) you need to determine if there is a gain or loss on the transaction. (Note sections 1001+)

The next list of code sections involve **tax entities** (corporations, partnerships, S corporations) which are covered in the corporate tax course. In this course, we will cover retirement plans and stock options starting with section 401 and section 421, respectively. There are some other groups of code sections that are somewhat important to us. Finally there are code sections dealing with procedural matters (you must file a tax return, you must keep records, you must pay your tax on time, etc.). (Sections 6001+)

Page 6 provides a short exercise with questions and a guide for finding answers in the code.

Page 7 walks you through the steps of analyzing code for a sale or exchange of property.

Page 8 is another page we will cover in some detail. Capital gains are covered in later chapters, but it's hard to cover the tax planning methods in chapter 3 without having an understanding of how the capital gain and loss rules impact that planning. I ask you to carefully read code section 1211(b), code section 1212(b) and code section 1221 and also code section 1222. Section 1(h) is an important code section, but very difficult to read.

Page 9 contains an important set of exercises that illustrate the limits on transferring income another related party (such as your son or daughter). We will work that page and discuss it in considerable detail.

Page 10 has a tax planning scenario involving a corporate executive who needs to decide whether to take an additional salary of $10,000 from the company, or take a dividend of $10,000. You are asked to identify the least costly approach considering both corporate and individual taxes.

Page 11 has a tax planning case about electing S status for a corporation.

Page 12 has a "fun" exercise for a hypothetical political family that goes to the casino and wins some money, and then loses some money. You're asked to explain the tax issues applicable to their gambling activities. Use code section 165 to find the answers.

Page 13 summarizes the way the estimated tax rules apply. Basically you are required to pay your income taxes throughout the year as you earn your income. For employees, that means having taxes withheld each paycheck. For those who have investment income and other income not subject to withholding, the law requires that you make quarterly estimated payments, or you may end up owe a penalty if you don't do that.

Page 14 has current income tax rates for individuals and corporations.

Pages 15 and 16 have 20 multiple-choice homework questions for you to work.
I will post the solutions to those questions on my course webpage.

You will also have a few homework problems for each chapter that you should submit through the Connect on-line system, by the textbook publisher – McGraw-Hill. I will provide a list of those questions.

(Studies show that grades are higher when students use the Connect system.)

I hope you find this memo and these sample exercises to be helpful.

Chapter 3. Tax Planning and Limits		Pg.	Exmp	Prb.	Sec.	Sub	
1.0	Basic Tax Planning Overview	2					
1.1	Timing Strategies	2					
	Shifting income to another year						
	Impacted by: present value. change in rates						
1.2	Present Value of Money	3	1, 2				
1.3	Timing Strategy - Constant rates	4	3, 4	38, 39			
				40, 41			
1.4	The Timing Strategy- Changing rates	7	5				
1.5	Limits to Timing Strategies	10	6				
	Constructive Receipt: Example, year-end bonuses				267	a	2
2.0	Income-Shifting Strategies	11					
2.1	Limits - Transactions with Family Members	11		55	267		
	Assignment of income. Lucas v. Earl						
	Low interest loans to relative, or corporation				7872		
2.2	Limits - Transactions between Bus. & Owner	12	7, 8	52			
	Deduct payments to owner. Dividend vs. interest, rent		9		162	a	1
	Look at income statement & retained earnings statement						
	See handout: electing S status for initial years with losses						
2.3	Limits - Income Shifting across Jurisdictions	15	10	54			
	Transfer pricing				482		
3.0	Conversion Strategies	16		57			
	"Break-even" type analysis. Taxable vs tax-free bonds		11, 12	58, 59	103		
3.1	Limits- Conversion Strategies	19			1	h	
4.0	Limits to Tax Planning Strategies:						
4.1	Judicial Doctrines	18					
	Business purpose, step transaction, substance over form.						
	Economic substance						
4.2	Tax Avoidance versus Tax Evasion	20					
5.0	Conclusion	21					

Example 3-3

Mercedes, a calendar-year taxpayer, uses the cash method of accounting for her small business.
On December 28, she receives a $10,000 bill from her accountant for consulting services.
She can avoid late payment charges by paying the $10,000 bill before January 10 of next year.
Let's assume that Mercedes' marginal tax rate is 30 percent this year and next and
that she can earn an after-tax rate of return of 10 percent on her investments.
When should she pay the $10,000 bill-this year or next?

Answer: If Mercedes pays the bill this year, she will receive a tax deduction on this year's tax return.
If she pays the bill in January, she will receive a tax deduction on next year's
tax return (one year later).
She needs to compare the after-tax cost of the accounting service
using the present value of the tax savings for each scenario:

Description		Option 1: Pay $10,000 this year	Option 2: Pay $10,000 next year
Tax deduction		$10,000	$10,000
Marginal tax rate		30%	30%
Tax savings		$3,000	$3,000
Discount factor		100%	90.9%
Present value tax savings		$3,000	$2,727
After-tax cost of accounting services:			
Before-tax cost		$10,000	$10,000
Less: Present value tax savings		($3,000)	($2,727)
After-tax cost of accounting services		$7,000	$7,273

This ignores the loss of the use of the funds for a few days - until January 10.

Example 3-4

Bill decides he would like to sell $100,000
of his Dell Inc. stock, which cost $20,000 10 years ago.
Assume Bill's tax rate on the $80,000 gain will be 15 percent.
His typical after-tax rate of return on investments is 7 percent.
He plans to sell the stock on December 30, 2014.
What effect would deferring the sale to January 1, 2015,
have on Bill's after-tax income on the sale?

Description	Option 1: Sell the $100,000 stock in December	Option 1: Sell the $100,000 stock in January
Sales price	$100,000	$100,000
Less: Cost of stock	($20,000)	($20,000)
Gain on sale	$80,000	$80,000
Marginal tax rate	15%	15%
Tax on gain	12,000	12,000
Discount factor	100%	93.5%
Present value tax cost	12,000	11,220
After-tax income from sale:		
Before-tax income	$100,000	$100,000
Less: Present value tax cost	($12,000)	($11,220)
After-tax income from sale	$88,000	$88,780

Bill would doubtlessly prefer to earn $88,780 to $88,000, so from
a tax perspective, selling the Dell Inc. stock in January is preferable.
(This ignores the requirement for making quarterly estimated income tax payments.)

Federal Income Tax Law

Taxes, Credits	**1-59**	**Taxes, credits, taxes (Subchapter A)**
	1-15	Rates - Individuals, Corporations (status 7703)
	21-52	Credits
	53-59A	Alternative Minimum Tax
Income, exclusions	**61-153**	**Income (Subchapter B)**
	61-68	Gross Income, Definitions
	71-90	Items included in income
	101-150	Items excluded from income
	151-153	Personal exemptions
Deductions	**161-248**	**Deductions**
	161-199	For Individuals & Corporations
	211-224	For Individuals
	241-249	For Corporations
	261-291	**Limits on deductions**
		See 261, 263, 267, 274, 280A, F, G
Property	**1000-1200s**	**Basis, Gain or Loss (Subchapter O, P)**
	1001, 1002+	Compute gain or loss, Basis rules
	1031-33	Tax free exchanges (tax deferred exchanges)
	1211, 12, 1221+	Capital assets, gains, losses
	1231,45,50,-291	Gain or loss on sale of business property
Entities	**Tax Entities, etc.**	
	300's	Corporations –Owner equity. (Subchapter C)
	700's	Partnerships. (Subchapter K)
	1361+	S corporations. (Subchapter S)
	401+	Retirement plans, (401(k)) etc. (Subchapter D)
	421+, Also 83	Stock options.
	501+	Non-profit organizations.
	641+	Trusts and estates. (Subchapter J)
Other	**Some other groups**	
	441 - 483	Accounting methods
	531+	Corporate penalty taxes (PHC, Accumulated Earn)
	800's	Insurance Companies, Mutual funds, etc.
	900's	Foreign income, etc.
	1401	Self-employment tax (Chapter 2)
	1501	Consolidated returns
	2001, 2501	Estate tax, Gift tax (Subtitle B)
Filing, penalties	**6000s - Records, returns, penalties (Subtitle F)**	
	6001	Taxpayers must keep records
	6012, 6072	Return - Indiv., Corp., Estate, Trust. Deadline
	6501, 6511	Statute of Limitations - Assessment, Refund
	6601, 6611	Interest on late or underpayment, refund
	6651, 6654	Penalty-late filing or payment of tax, Estimated tax
	6662, 6694	Penalty for bad research- Taxpayer. Preparer.
Define	**Definitions**	
	7701, 7805	Definitions – check-the-box. Regulations.

No.	Questions about the Tax Law	Sec.	Sub
	Is income tax a voluntary tax, or a tax payment required?		
1	**Income tax is imposed on "taxable income" of Individuals**	**1**	**a**
2	**Income tax is imposed on "taxable income" of Corporations**	**11**	**a**
	What is taxable income?		
3	"Taxable income" **is "gross income," less allowable deductions.**	**63**	
4	"Gross Income" **is defined to include almost all types of income**	**61**	
	What is Adjusted Gross Income?		
5	**"Adj. Gross Income is Gross Income, less deductions listed in this section**	**62**	
	Find each deduction for AGI on the individual income tax return.		
	Is a person's salary included in Gross Income?		
6	**Gross income includes compensation according to the Code**	**61**	**a 1**
7	**Gross income includes compensation according to the Regulations**	**1.61**	**2**
	How does taxpayer report federal withholding from salary?		
8	**Withholding is a credit against the tax liability.**	**31**	**a**
	How does taxpayer report N.C. income tax withholding?		
9	**Is Income tax paid to NC deducted to get taxable income (Indiv & Corp)**	**164**	**a 3**
10	**Is Income tax paid to NC deducted to get adjusted gross income?**	**62**	
11	**Is deduction of NC income tax subject to threshold (2% of AGI)? Sch. A**	**67**	
12	**Would the deduction be phased out for a high income taxpayer?**	**68**	
	Types of interest income included in gross income?		
13	**Is interest income from Wells Fargo taxable?**	**61**	
14	**Is interest income from City of Concord taxable?**	**103**	
15	Do you include a gift from parents in gross income?	**102**	**a**
16	**What if the gift is from your employer?**	**102**	**c**
17	Do you deduct alimony payments made to a former spouse?	**215**	
18	**See also section applicable to the former spouse receiving alimony.**	**71**	**a , b**
19	**If alimony is deductible, is the deduction taken to get AGI?**	**62**	
20	May you deduct medical expense paid for your daughter?	**213**	**a**
21	**Is the medical expense deduction subject to a limit?**	**213**	**a**
22	May you deduct charitable contributions made by your daugher?	**170**	**a 1**
23	May you choose a standard deduction?	**63**	**c**
24	May you deduct an exemption amount for yourself?	**151**	**b**

Code Analysis for Property Transactions

Individual sells land that had been held as an investment for 2 years. Land has cost of $600,000. Land was sold for $1,000,000. Otherwise individual has gross income of $100,000 (all from salary) and no losses.

	Sec	Topic
1	1(a)	Tax is imposed
2	63(a)	Taxable Income
3	61(a)(3)	Gross Income includes gains from dealing in property
4	1001(a), (b)	Compute gain included in gross income
	(c), (d)	General rule – recognition of all gains
5	1012(a)	Cost basis of property
6	1(h)	Special income tax rate for long-term capital gains
7	1221(a)	Definition of capital asset
8	1222(11)	"Net capital gain"
9	1222(3)(7)	Long-term

Individual trades land for an apartment building worth $1,000,000. (Land: Cost = $600,000, Value = $1,000,000.) Otherwise individual has gross income of $100,000 (all from salary) and no losses.

	Sec	Topic
3	61(a)(3)	Gross Income
4	1001(a), (b)	Compute gain included in gross income
	(c), (d)	General rule – recognition of all gains
5	1031(a)(1)	Like kind exchange
6	1031(d)	Cost basis of apartment
7	1223(1)	Holding period basis

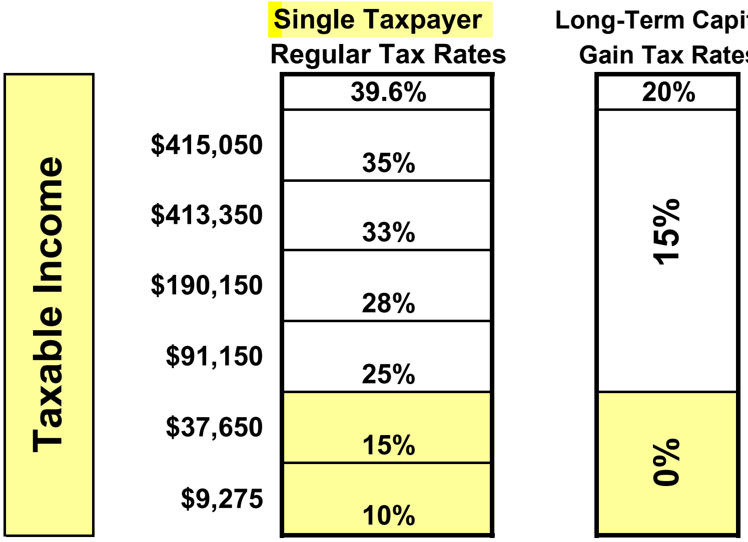
Additional analysis required if TP receives an apartment worth $950,000 and cash of $50,000, etc

Owner dies owning land (cost = $600,000, FMV $1,000,000). Heir sells it for $1,100,000 four months later.

	Sec	Topic
1	1(a)	Tax is imposed
2	63(a)	Taxable Income
3	61(a)(3)	Gross Income
4	1001(a),(b)	Compute gain included in gross income
	(c), (d)	General rule – recognition
5	1014(a)(1)	Cost basis of inherited land
7	1223(9)	Holding period basis

Can you give appreciated property to a terminally ill parent, and then inherit it with a higher (FMV) basis? (Sec. 1014(e))

Capital Gains Rates for Individuals - 2016



Text Page	8-4
Code Section	1(h)
(difficult to read)	
Code Section	1211(b)
Code Section	1212(b)
Code Section	1221(a)
Code Section	1222

Special rates:

Unrecaptured Gain	Text 7-10
Collectibles	Text 7-10

Susan is single and has no dependent. She started investing in stock in 2015.
Susan has total exemptions and itemized deductions of $20,000 per year.
She has no other deduction, except for any allowable capital loss deduction
Assume: Current tax law and current tax rates will be in effect in all years.

	2015	2016	2017	2018
Salary and lottery winnings	$50,000	$50,000	$90,000	$500,000
S.T. gain (loss) sale of IBM stock	(5,000)	0	0	0
L.T. gain (loss) sale of ABC stock	1,000	5,000	10,000	10,000
Loss brought forward from last year	0	(1,000)	0	0
Net Capital gain or (net capital loss)	(4,000)	4,000	10,000	10,000
Net gain reported (or net loss deducted)	(3,000)	4,000	10,000	10,000
AGI	$47,000	$54,000	$100,000	$510,000
Deductions	($20,000)	($20,000)	($20,000)	($20,000)
Taxable income	$27,000	$34,000	$80,000	$490,000
Federal income tax before credits				

What is the amount federal income tax before credits for 2016?

Ordinary income - Salary	$50,000		
Long-term Capital Gain	$4,000		
Exemptions and deductions	(20,000)		
Taxable income	$34,000		
Remove Long-term Capital Gain	($4,000)		
Income taxed at ordinary rates	$30,000		
Amount taxed at lower rates & tax	9,275		$927.50
Top layer at marginal rate & tax	20,725	15%	3,108.75
Income taxed at ordinary rates	$30,000		
Income tax at ordinary rates			4,036.25
Net Capital Gains & Tax	$4,000	0%	0.00
Total tax before credits			4,036.25

Instructor Note: Capital gains are covered in later chapters, but you can't fully understand the tax planning opportunities discussed in Chapter 2, without undertanding capital gains taxation.

No.	[Assume Father is in top marginal income tax rate and that is 39.6% (use 40%).]				Sec.	
1	Father bought IBM stock on January 1, 2016 for:		$20,000		61	
	Father sold all of the IBM stock on 12-31-2016 for:		$100,000			
	FMV - Selling Price of IBM stock	$100,000				
	Cost Basis	$20,000				
	Gain on sale of IBM stock	$80,000			1001	
	Tax Rate	40.0%				
	Income Tax applicable to the sale	$32,000				
	After-Tax cash flow from sale	$68,000				
	Is the asset a capital asset, generating capital gain?			Yes	1221	
	Is the gain short-term or long-term?			ST	1222	3
	Does taxpayer use special capital gains tax rate?			No	1	h
	Is it a net capital gain?			No	1222	11
2	Father gave stock (Part 1 above) to his son on 12-31-2016.				61	
	Son immediately sold the stock. Son's marginal rate is 25%.					
	What is tax impact on son, who immediately sold the stock?					
	Selling Price	$100,000				
	Cost Basis	$20,000				
	Gain	$80,000			1001	
	Tax Rate	25%				
	Income Tax	$20,000				
	After-Tax cash flow	$80,000				
	This assumes the gain does not push him into higher bracket.					
	What is son's cost basis in property received as gift?				1015	
	When does son's holding period start?				1223	2
	Is the gain a capital gain			Yes	1221	
	Is the gain a long-term capital gain			No	1222	3
	Son's basis in land, if father paid gift tax of $10,000?		$28,000		1015	
3	Cases 1 & 2 (IBM Stock was bought in 2010)					
	Assume no gift tax paid by Taxpayer. IBM stock was sold in 2016.				1	h
	Father's capital gain income tax rate if Father sells the stock			20%		
	Son's capital gain tax rate if son receives stock as gift and sells it.			15%		
4	Loss - Case 1 Modified					
	Father bought IBM stock on 1-05-2017 for:		$100,000			
	Father sold all of the IBM stock on 12-31-16 for:		$20,000			
	Father also bought stock in HP Corporation in 2016					
	and sold it in 2016 for gain of $140,000					
	FMV - Selling Price of IBM stock	$20,000			61	
	Cost Basis	$100,000				
	Gain (loss) on IBM stock	($80,000)			1001	
	Tax Rate for gain on HP stock	40.0%				
	Income Tax	($32,000)				
	After-Tax cash flow	$52,000				
	If Father has LT capital gain on HP, savings are at the 20% tax rate.					
5	Loss Spreading - Case 2 modified					
	TP (Father) paid $100,000 for the IBM stock.		$100,000		61	
	Father gave IBM stock to son when it had a FMV		$20,000			
	What is tax impact on son, who immediately sold the stock?					
	Selling Price of IBM stock	$20,000				
	Cost Basis-for gain on sale	$100,000				
	Cost Basis-for loss on sale	$20,000			1015	
	Gain (loss) realized	$0				
	Loss allowed	$0				
	Tax Rate	N/A				
	Income Tax Savings	$0				
	After-Tax cash flow	$20,000				

Take Extra Salary or Dividend?

Joan is married (no dependent.) Her salary is $230,000 per year from her 100% owned corp.
She has total exemptions and itemized deductions of $30,000. (Taxable income: $200,000)
Ignore phase-out of exemptions and itemized deductions. Ignore Sections 68(b) 151(d)(3).
Her wealth is tied up in her corporation. She has no investment income. No State Income tax.
She invested $1,000,000 for all of the corporate stock (to start corporation) on Jan. 1, 2016.
She "planned" to take no dividend - and use all profits for expansion of the corporation.
There is no issue of reasonableness of her salary or unreasonable accumulation of earnings.

She projected that her corporation's taxable income is as follows 2016:

Corporate Revenue	$900,000		
Various expenses	(595,000)		
Owner salary	(230,000)		
Corporate Taxable income	75,000		
Section 11	$50,000	15%	$7,500
	$25,000	25%	6,250
Total Corporate Income Tax			$13,750

ASSIGNMENT- Joan's husband wants her to take him on an ocean cruise at a cost of almost $10,000. She will take a bonus of $10,000, or a dividend of $10,000 in 2016. Which option causes smaller increase in individual & corp. taxes (income tax & FICA)?

What is the impact on the Corporation if a $10,000 bonus is paid?

Additional payroll	$10,000	
FICA Rate	1.45%	
Additional payroll tax	$145	
Change in taxable income	($10,145)	
Marginal income tax rate	25%	Sec. 11
Corporate tax savings.	($2,536.25)	
Additional corporate payroll tax	$145.00	
Net impact on corporate taxes	($2,391.25)	

Will payment of a dividend affect taxable income of the corporation? No

What is the impact on the Joan, if she receives a $10,000 bonus?

Additional Salary	$10,000	
Marginal tax rate	28.00%	Sec. 1
Additional income Tax	$2,800	
Employee share of FICA	$145	
Additional tax paid by Joan	$2,945	

What is the impact on the Joan if she receives a $10,000 dividend?

Joan will pay additional income tax of : $1,500
(i.e. additional tax with dividend compared to no bonus or dividend.)

Which alternative involves less total currrent individual and corporate taxes?

	Bonus	Dividend
Increase or decrease in corporate taxes	($2,391.25)	$0
Increase or decrease in individual taxes	$2,945.00	$1,500
Additional current combined tax burden	$553.75	$1,500

How would your answer change if corporate taxable income is $50,000?
Would you recommend election of S status (ignore bonus or dividend payment)?

Rich Corporation (100% owner: Mr. Rich)	
Revenue	$200,000
Expense other than owner salary	70,000
Salary to owner (Mr. Rich)	40,000
Corporate taxable income	$90,000

This is the first year of operations for Rich Corporation. There is no state income tax.

Corporate income tax computation				
0	50,000	15%	50,000	7,500
50,000	75,000	25%	25,000	6,250
75,000	100,000	34%	15,000	5,100
100,000	335,000	39%		
Corporate taxable Income and tax			**90,000**	**18,850**

Individual Tax Return - Mr. Rich	W/ C Corp	W/ S Corp
Rich (Single, under age 50) Corporate Salary	$40,000	$40,000
Flow-through from cororation		$90,000
Exemption & itemized deductions	($20,000)	($20,000)
Rich's Taxable income	$20,000	$110,000

Single-2016- with C corp	Base	Rate	Tax
Lower layer (s)	$9,275		$928
Top layer for Rich	10,725	15%	1,609
Rich's Income and Tax	$20,000		$2,536

Single-2016- with S Corp	Base	Rate	Tax
Lower layer (s)	$91,150		$18,559
Top layer for Rich	18,850	28%	5,278
Rich's Income and Tax	$110,000		$23,837

Individual Income Tax Rates - Single Person - 2016

Individual taxable income:		Total Individual Federal Income Tax - Single			
Over	But Not Over	Tax on all Previous Layers		Plus	of Taxable Income over:
$0	$9,275	0.00	+	10%	$0
9,275	37,650	927.50	+	15%	$9,275
37,650	91,150	5,183.75	+	25%	$37,650
91,150	190,150	18,558.75	+	28%	$91,150
190,150	413,350	46,278.75	+	33%	$190,150
413,350	415,050	119,934.75	+	35%	$413,350
$415,050		120,529.75	+	39.6%	$415,050

Total Income Tax Burden in 2016	With C Corp.	With S Corp.	
Corporate Tax	$18,850	$0	
Individual Tax	2,536	23,837	
Total income tax	$21,386	$23,837	$2,451

Gambling Losses

Part I.

Bill and Hillary were married on New Years Eve, 2016, in Atlantic City.

They celebrated at the casino.

Hillary played blackjack. She won $20,000, then lost $5,000.

Bill chose another game. He began well, by winning $10,000.

His luck did not hold out – he then lost $30,000.

They reviewed their situation.

They realized that they had won a total of $30,000, but lost a total of $35,000.

It was almost midnight by now, so they left the casino.

They went to their room to watch the falling of the ball at Times Square.

How will these losses and gains be combined and reported on their Form 1040 for 2016?

You may want to refer to Internal Revenue Code Section 165 and the related Regulations.

Part II. Facts Changed

Bill and Hillary were married on New Years Eve, 2016, in Atlantic City.

They celebrated at the casino.

Hillary played blackjack. She won $20,000.

Bill chose another game. He began well, by winning $10,000.

They reviewed their situation.

They realized that they had won a total of $30,000.

It was almost midnight by now, so they left the casino.

They went to their room to watch the falling of the ball at Times Square.

Shortly after midnight, they decided to go back to the casino.

They wanted to double their money.

Unfortunately, Hillary lost $15,000 and Bill lost $15,000.

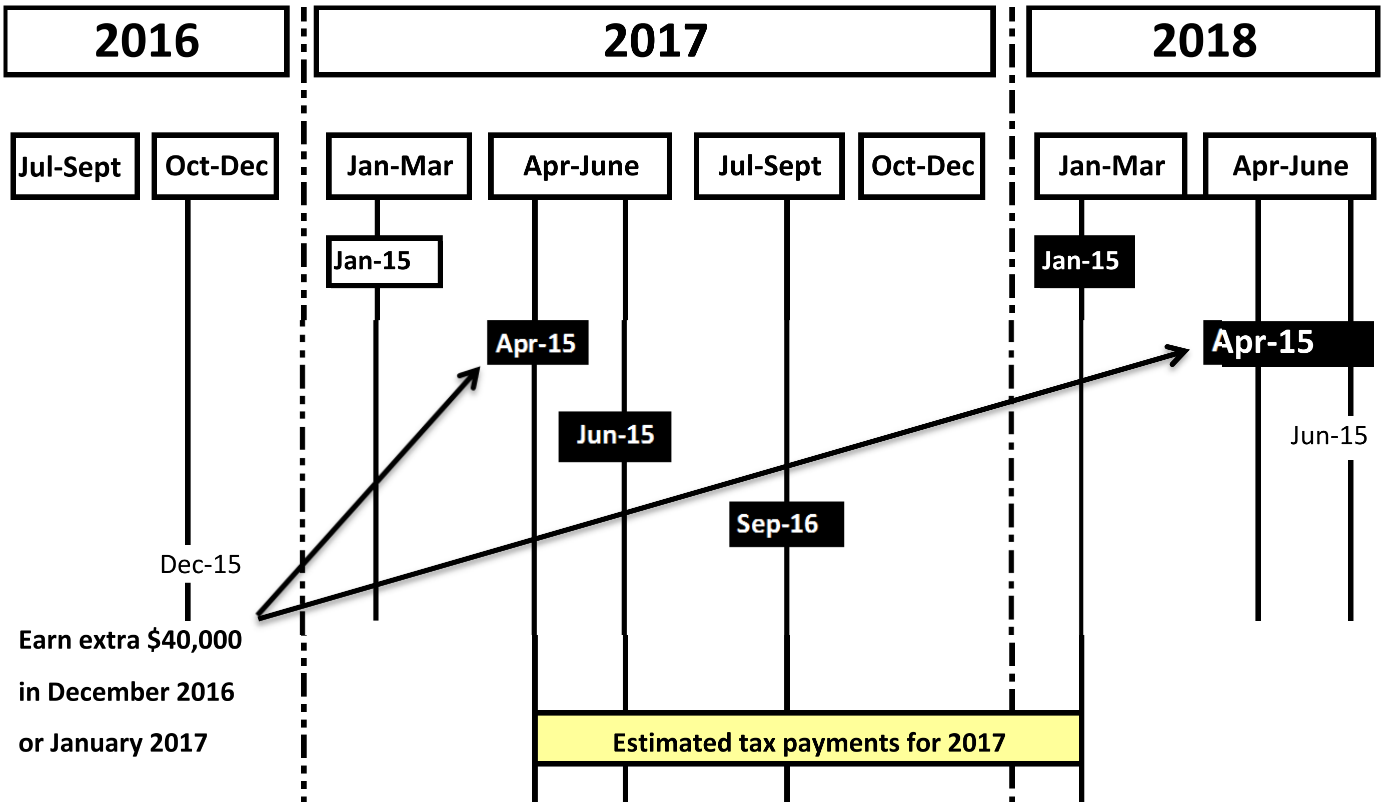
Fortunately they had won $30,000 ($20,000 and $10,000) a few hours earlier.

They took it well, after all, they broke even.

How will these losses and gains be reported?

You may want to refer to Internal Revenue Code Section 165

and the related Regulations.



We usually analyze problems such as this one, assuming you can delay the payment of the income tax for one year. Actually, the estimated tax rules make that assumption questionable, if a large amount of income is being deferred

Code Section 6654(d)(1), etc.

Federal IncomeTax Rates-Single. 2016

Taxable income:		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers		Plus	of Taxable Income over:
$0	$9,275	0.00	+	10%	$0
9,275	37,650	927.50	+	15%	9,275
37,650	91,150	5,183.75	+	25%	37,650
91,150	190,150	18,558.75	+	28%	91,150
190,150	413,350	46,278.75	+	33%	190,150
413,350	415,050	119,934.75	+	35%	413,350
$415,050		120,529.75	+	39.6%	415,050

Example: with taxable income of $9,375, rate is 10% on $9,275 and 15% on $100

Federal Income Tax Rates:Joint - 2016.

Taxable income:		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers		Plus	of Taxable Income over:
$0	$18,550	0.00	+	10%	$0
18,550	75,300	1,855.00	+	15%	18,550
75,300	151,900	10,367.50	+	25%	75,300
151,900	231,450	29,517.50	+	28%	151,900
231,450	413,350	51,791.50	+	33%	231,450
413,350	466,950	111,818.50	+	35%	413,350
$466,950		130,578.50	+	39.6%	466,950

Income Tax Rates - Separate - 2016.

Taxable income:		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers		Plus	of Taxable Income over:
$0	$9,275	0.00	+	10%	$0
9,275	37,650	927.50	+	15%	$9,275
37,650	75,950	5,183.75	+	25%	$37,650
75,950	115,725	14,758.75	+	28%	$75,950
115,725	206,675	25,895.75	+	33%	$115,725
206,675	233,475	55,909.25	+	35%	$206,675
$233,475		65,289.25	+	39.6%	$233,475

	AGI Phase-out Thresholds	
Filing Status	Exemptions	Itemized Deduct.
Married, Joint	311,300	311,300
Head-of-Household	285,350	285,350
Single	259,400	259,400
Married, Separate	155,650	155,650

Exemptions reduced by:
2% for each $2,500 layer above AGI Threshhold above
(for married filing separately, layer is $1,250)
Itemized Deductions reduced by:
3% of excess of AGI over AGI Threshhold above

Income Tax Rates - Head of Household - 2016.

Individual taxable income		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers		Plus	of Taxable Income over:
$0	$13,250	0.00	+	10%	$0
13,250	50,400	1,325.00	+	15%	13,250
50,400	130,150	6,897.50	+	25%	50,400
130,150	210,800	26,835.00	+	28%	130,150
210,800	413,350	49,417.00	+	33%	210,800
413,350	441,000	116,258.50	+	35%	413,350
$441,000		125,936.00	+	39.6%	441,000

Standard Deduction	Basic	Age/ Blindness
Single	$6,300	$1,550
Married-Joint	$12,600	$1,250
Married - File Separately	$6,300	$1,250
Head of Household	$9,250	$1,550
Personal Exemption Amount	$4,050	

AMT Exemption	Amount	Phase-out	
Joint Return	$83,800	$159,700	$494,900
Separate Return	$41,900	$79,850	$247,450
H-of-H and Single	$53,900	$119,700	$335,200

AMT Tax Rates	Amount	Rate
Rate on AMT base up to	$186,300	26%
Rate on AMT base above	$186,300	28%

FICA rate on salary up to	$118,500	7.65%
FICA rate on excess	Excess	1.45%

Federal Corporate Income Tax Rates

Taxable Income over	but not over	The tax is:			Of the amount over:
$0	$50,000	$0	+	15%	$0
50,000	75,000	7,500	+	25%	50,000
75,000	100,000	13,750	+	34%	75,000
100,000	335,000	22,250	+	39%	100,000
335,000	10,000,000	113,900	+	34%	335,000
10,000,000	15,000,000	3,400,000	+	35%	10,000,000
15,000,000	18,333,333	5,150,000	+	38%	15,000,000
18,333,333				35%	

Homework for Chapter 3. Acct 6160

1. A cash basis corporation is in the 15% tax bracket in 2016 and will be in the 35% bracket in 2017. If certain bills are paid in 2016, a current tax deduction will be allowed for those payments. If customers are billed for November services in early December, many of those customers will make their payments before December 31, 2016. If billing is delayed a couple of weeks, collections will be in January, 2017. How should the corporation manage its 2016: **(1)** end-of-year payments of accounts payable and **(2)** end-of-year billing and collection of accounts receivable?

	(1) Accounts Payable	(2) Accounts Receivable
a.	Accelerate payment	Accelerate Billing and Collection
b.	Defer Payment	Accelerate Billing and Collection
c.	Accelerate payment	Defer Billing and Collection

2. A single, wealthy investor earns net rental income of about $400,000 per year. She does not have significant itemized deductions. She is considering giving some rental property (that generates net rental income of $20,000 per year) to her elderly mother so that her mother will have income she needs for her living expenses.
The investor expects to save federal income taxes with this plan. Which planning concept applies here?

a. Timing of income. **b.** Income shifting
c. Changing character of income **d.** Step transaction doctrine

3. A corporation in the 39% marginal tax bracket can pay a marketing consultant $10,000 to develop a campaign that will generate $50,000 in new revenue. Alternatively, the corporation can pay 10,000 to a tax consultant to develop a tax plan that will save $50,000 in taxes. Which project provides the highest net after-tax cash flow?

a. Marketing b. Tax planning

4. Planning the timing of revenue recognition can yield benefits because of:

a. Time value of money b. Changing marginal tax rates c. Both

5. Pam has $100,000 to invest for 5 years. She is considering a land investment that she expects will appreciate at the rate of 6% per year, or a savings account that will pay interest of 6% per year. Both investments involve annual compounding. After-tax earnings on the savings account would be reinvested in the savings account at 6%.
How do these investments compare in terms of (1) tax deferral and (2) income tax rates?

	Savings Account	Land Investment
a.	More tax deferral	Lower tax rate
b.	Less tax deferral	Lower tax rate
c.	Less tax deferral	Higher tax rate

6. A calendar year cash basis taxpayer, projected its taxable income to be $70,000 for 2016, and $40,000 for 2017. After making these projections for 2016 and 2017, the company decided to have a local advertising campaign for the 2016 winter holidays costing $10,000. This cost was not included in the income projections above. The company has a choice of paying the advertising bill in late December or in early January.
Ignoring time value of money, how much is the company's net savings by paying the bill in December 2017?

a. $7,500 **b.** $1,500 **c.** $2,500 **d.** $1,000

7. On December 31, Bill decides he would like to sell his Dell Inc. stock, which cost $20,000 10 years ago.
Assume Bill's tax rate on the $80,000 gain will be 15%. His after-tax rate of return on investments is 7%
The stock has a value on December 28 of $100,000. Bill thinks the stock market may fall and he projects the value of the stock will to be $95,000 in early 2014. He will pay the additional tax with the next federal income tax return filed on April 15, 2014 or 2015. There will be no penalty for underpayment of income tax. Should bill sell in:

a. December. **b.** January

8. Mercedes has decided she needs new equipment costing $10,000 for her business.
Mercedes is considering whether to make the purchase and claim $10,000 deduction at year-end or next year. With the new machinery, her business income will rise. Assume her after-tax rate of return is 8 percent. Her marginal rate will increase from 20 percent this year to 28 percent next year. She is considering buying the machine (and paying cash) on December 20, 2016, or January 5, 2017. What is the PV of the after-tax cost of the machine if she buys the machine on January 5, 2017?

a. $7,407 **b.** $7,500 **c.** $8,000 **d.** $8,100 **e.** Other

9. Which of the following decreases the benefits of accelerating deductions?

a. Lower tax rates in the future **b.** Higher tax rates in the future
c. Larger after-tax rate of return **d.** larger magnitude of transactions

10. Which of the following is an example of the timing strategy?

a. A corporation paying its shareholders a $20,000 dividend
b. A parent employing her child in the family business
c. A taxpayer gifting stock to his children
d. A cash-basis business delaying billing its customers until after year end

11. Rudy has a 25% tax rate and a 6% after-tax rate of return.
A $30,000 tax deduction in four years will save how much tax in today's dollars (rounded)?

a. $30,000 **b.** $7,500 **c.** $28,290 **d.** $5,940 **e.** Other

12. Julius has a 30% tax rate and a 10% after-tax rate of return.
A $40,000 tax deduction in two years will save how much tax in today's dollars (rounded)?

a. $40,000 **b.** $9,917 **c.** $33,040 **d.** $12,000 **e.** Other

13. Jason's employer pays year-end bonuses each year on Dec. 31. Jason, a cash basis taxpayer, would prefer to not pay tax on his bonus this year. (He would actually would prefer his daughter to pay tax on the bonus). So, he leaves town on December 31, 2015 and has his daughter, Julie, pick up his check on January 2, 2016. Who reports the income and when?

a. Julie in 2015 **b.** Julie in 2016 **c.** Jason in 2015 **d.** Jason in 2016

14. A common income shifting strategy is to:

a. shift income from low tax rate taxpayers to high tax rate taxpayers
b. shift deductions from low tax rate taxpayers to high tax rate taxpayers
c. shift deductions from high tax rate taxpayers to low tax rate taxpayers
d. accelerate tax deductions

15. A taxpayer paying his 10 year-old daughter $50,000 a year for consulting violates which doctrine?

a. constructive receipt doctrine **b.** implicit tax doctrine
c. substance-over-form doctrine **d.** step-transaction doctrine

16. A taxpayer instructing her son to collect rent checks for the taxpayer's property and to report this as taxable income on the son's tax return violates which doctrine?

a. constructive receipt doctrine **b.** implicit tax doctrine
c. assignment of income doctrine **d.** step-transaction doctrine

17. Assume that Bill's marginal tax rate is 30%. If corporate bonds pay 8% interest, what interest rate would a municipal bond have to offer for Bill to be indifferent between the two bonds?

a. 30% **b.** 10.4% **c.** 8% **d.** 5.6% **e.** Other

18. Assume that John's marginal tax rate is 40%. If a city of Austin bond pays 6% interest, what interest rate would a corporate bond have to offer for John to be indifferent between the two bonds?

a. 30% **b.** 10% **c.** 6% **d.** 3.6% **e.** Other

19. Assume that Larry's marginal tax rate is 25%. If corporate bonds pay 10% interest, what interest rate would a municipal bond have to offer for Larry to be indifferent between the two bonds?

a. 25% **b.** 12.5% **c.** 10% **d.** 7.5% **e.** Other

20. Assume that Will's marginal tax rate is 32% and his tax rate on dividends is 15%.
If a dividend-paying stock (with no growth potential) pays a dividend yield of 8%, what interest rate must the corporate bond offer for Will to be indifferent between the two investments?

a. 12% **b.** 11% **c.** 10% **d.** 8% **e.** Other