**CHAPTER 5 – GROSS INCOME AND EXCLUSIONS.**



**The tax year is assumed to be 2016, unless the problem directs you to use another year.**

|  |  |
| --- | --- |
| **Concepts: Benefit, Realize, Recognize** | **[2]** |

**[Pg. 5-3]** Bennett Hanover purchased a tract of land for $20,000 in 2007 when he heard that   
a new highway was going to be constructed through the property and that the land would soon   
be worth $200,000. Highway engineers surveyed the property and indicated that he would   
probably get $175,000. The highway project was abandoned in the current year and the value   
of the land fell to $15,000. Hanover can claim a loss for the current year of:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $5,000 | **b.** | $160,000 | **c.** | $180,000 | **d.** | $185,000 | **e.** | Zero | **E** |

|  |  |
| --- | --- |
| **Form of receipt, Return of capital** | **[4]** |

**[Pg. 5-3]** After buying books at the beginning of the semester, Dolly found a $100 bill   
outside the bookstore. She tried, but could not locate the owner of the money.   
The $100 is considered gross income. Which of the following supports this treatment?

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | All-inclusive Income Concept. | **b.** | Capital Recovery Concept. | **A** |
| **c.** | Wherewithal-To-Pay Concept. | **d.** | Administrative Convenience. |
| **e.** | Constructive Receipt Doctrine. |  |  |

|  |  |
| --- | --- |
| **Tax benefit rule: [refund of amount deducted earlier]** | **[5: 51]** |

Calvin (single, age 30, no dependent) had $2,000 of state income taxes withheld from his salary   
in **2016.** Calvin properly claimed itemized deductions of $6,400 on his Form 1040 for 2016.   
His 2016 state tax return showed a $500 refund, which he received on May 25, 2017. Calvin should:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | Ignore the state income tax refund – do not report it to the IRS | | | **C** |
| **b.** | Amend the federal return for 2016 and report correct amount of state income tax for 2016. | | | |
| **c.** | Include the state income tax refund of $100 in income on the 2017 federal income tax return. | | | |
| **d.** | Include the state income tax refund of $200 in income on the 2017 federal income tax return | | | |
| **e.** | Include the state income tax refund of $300 in income on the 2017 federal income tax return | | | |
| **Recognize income: Accounting methods,** | | **[6]** |
| **Constructive Receipt, Claim of Right** | | **[7]** |

|  |  |
| --- | --- |
| **Who Recognizes? Assignment of income** | **[8]** |

**See text page 3-12 and applicable “homework” problems in that chapter**

|  |  |
| --- | --- |
| **Income: Compensation for services** | **[10]** |
| **STOCK OPTIONS: Nonqualified Options and ISOs** | **[10: 56]** |

**Use the following information for the next five questions.**

Harold started working for Big Corp. 3 years ago when the company’s stock price was **$7** per share.   
At that time, Harold received 100 non-qualified stock options.  
Each option gave him the right to purchase 20 shares of Big Corporation stock for **$7** per share.

On June 1, 2015, the options vested, when Big Corporation’s share price is **$40** per share,

On June 1, 2015, Harold exercised all of his options, acquiring the 2,000 shares.   
(no restriction on sale of stock)

On June 1, 2016, Harold sold all of the shares, at a price of **$60** per share.

Harold is single. Harold’s salary is $500,000 per year, and his total deductions are $40,000 per year.

How much income or gain does Harold recognize in 2015?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $14,000 | **c.** | $40,000 | **d.** | $66,000 | **e.** | Other | **D** |

How much income or gain does Harold recognize in 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $14,000 | **c.** | $40,000 | **d.** | $66,000 | **e.** | Other | **C** |

What is the amount of the tax deduction that will be claimed by Big Corporation?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $14,000 | **c.** | $40,000 | **d.** | $66,000 | **e.** | Other | **D** |

What income tax rate will apply to the income recognized in 2015?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 0% | **b.** | 15% | **c.** | 20% | **d.** | 39.6% | **e.** | Other | **D** |

What income tax rate will apply to the income recognized in 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 0% | **b.** | 15% | **c.** | 20% | **d.** | 39.6% | **e.** | Other | **C** |

**Use the following information for the next three questions.**

On June 10, 2011, Big Corporation gave 10 ISOs to Mark, when Big’s stock was worth $5 per share.

Each option gave Mark the right to purchase 10 shares of Big Corporation stock for $5 per share.

On June 1, 2015, the options vested. On that day, the stock was worth $25 per share.  
On June 1, 2015, Mark exercised all options (bought 100 shares). (no restriction on sale of the stock)

On June 5, 2016, Mark sold all of the stock for $35 a share.

How much income or gain does Mark recognize when computing regular income tax for 2015?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $1,000 | **c.** | $2,000 | **d.** | $3,000 | **e.** | Other | **A** |

How much income does Mark recognize when computing alternative minimum taxable   
income for 2015?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $1,000 | **c.** | $2,000 | **d.** | $3,000 | **e.** | Other | **C** |

How much income or gain does Mark recognize when computing regular income tax for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $1,000 | **c.** | $2,000 | **d.** | $3,000. | **e.** | Other | **D** |

 On June 10, 2011, Joan received 2,000 shares of restricted stock from her employer,   
Independence Corporation, when the share price was $10 per share.

On June 10, 2014, Joan's restricted shares vested, when the market price was $14 per share.

On June 20, 2015, Joan sold all of the stock when the market price was $16 per share.

Joan made a Section 83(b) election. What amount of ordinary income did Joan recognize?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $12,000 | **b.** | $20,000 | **c.** | $28,000. | **d.** | $4,000 | **e.** | Other | **B** |

 On June 1, 2011, Ann received 2,000 shares of restricted stock from her employer,   
Independence Corporation, when the share price was $10 per share.

On June 1, 2014, Ann's restricted shares vested, when the market price was $14 per share.

On June 3, 2016, Ann sold all of the stock when the market price was $16 per share.

Ann did **not** make a Section 83(b) election. What is Ann's gain or loss on the sale?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $12,000 | **b.** | $20,000 | **c.** | $28,000. | **d.** | $4,000 | **e.** | Other | **D** |

|  |  |
| --- | --- |
| **Income from Property, Annuity, Dividend** | **[12: 59], & 14-3** |

**[Pg. 5-13]** Jose is the beneficiary of a $100,000 insurance policy on his wife's life.   
Jose elects to receive $12,000 per year for 10 years rather than receive $100,000 in a   
lump sum. In effect, Jose is buying an annuity. Of the amount received each year

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | $12,000 is tax free. | | | **b.** | $12,000 is taxable income. | **E** |
| **c.** | $5,000 per year is tax free as a death benefit | | | **d.** | $2,000 is tax free |
| **e.** | $2,000 is taxable. |  |  | | |

**[Pg. 5-13]** On **December 31, 2013,** Bo bought an annuity for $50,000. The annuity begins   
payment of $1,000 per month in January, 2016, and will pay $1,000 monthly to Bo as long as   
he lives. Bo had a life expectancy of 5 years on January 1, 2016. How much of the $12,000   
received in 2016 should be included in Bo’s income?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Zero | **b.** | $2,000 | **c.** | $10,000 | **d.** | $12,000 | **B** |

**[Pg. 5-13]** Penelope purchased an annuity contract that cost $45,000.   
The contract will pay Penelope $600 per month for 10 years after she reaches age 62.   
During the current year, Penelope turned 62 and received 4 payments under the contract.   
Penelope's taxable income from the annuity payments is:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $900 | **b.** | $1,500 | **c.** | $1,708 | **d.** | $2,250 | **e.** | $2,400 | **A** |

**[Pg. 5-13]** Martin purchased an annuity contract at the beginning of 2003 for $84,000.   
The contract specifies that he will receive $2,000 per month for life. Martin receives his   
first payments on July 1, 2010, when he was **70 years old**.   
Martin died on August 15, 2016. (August payment was received prior to his death) when a   
bolt of lightning hit him. What amount, if any, should be deducted on Martin's 2016 tax   
return as a result of failing to receive his expected return on the annuity contract?

|  |  |  |
| --- | --- | --- |
| **a.** | A $51,625 loss can be claimed as a deduction on his final return. | **A** |
| **b.** | A $50,400 loss can be claimed as a deduction on his final return. |
| **c.** | A $1,600 loss can be claimed as a deduction on his final return. |
| **d.** | No loss is reported because a decedent is not required to file a final return. |

**[Pg. 5-13n]** On January 1, 2016, Local Corp. received a loan from an investor in the amount of $165,289.26. The loan matures on December 31, 2017. At that time Local Corp. will pay the maturity value of $200,000. Assume the interest rate is 10%. Assume interest is compounded annually under the loan contract and under the income tax law. How much income is recognized by the investor for 2017?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $16,528.93 | **b.** | $17,355.37 | **c.** | $18,181.82 | **d.** | Other | **C** |

**[Pg. 5-13n]** On January 1, 2016, Gold Corporation purchased Fay Corp. 9% bonds with a   
face amount of $400,000 for $375,422, to yield 10%. The bonds are dated January 1, 2016,   
mature on December 31, 2025, and pay interest annually on December 31. Gold uses the   
interest method of amortizing discount. What is Gold’s interest revenue for **2016**?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $37,542 | **c.** | $36,000 | **d.** | $37,696 | **B** |

|  |  |
| --- | --- |
| **Property dispositions: Gain or Loss** | **[15]** |

|  |  |
| --- | --- |
| **CAPITAL GAINS: Netting, Loss carryover, etc.** | **[16: 64]** |

Jeremy and Joan (his wife) earned total salaries of $100,000 ($50,000 each) in the   
current year. Joan earned corporate bond interest income of $6,000 in 2015.   
They have one qualifying dependent child who lives with them.   
The child does not qualify for the child credit.   
They have total itemized deductions of $17,000, after considering all limits and phase-outs.

What is their income tax liability before credits on a joint federal tax return (nearest dollar)?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $10,755 | **b.** | $12,000 | **c.** | $11,144 | **d.** | $12,251 | **e.** | Other | **A** |

Use information in preceding question.Assume you learn that Jeremy and Joan also had   
total capital gains of $2,000 in the current year, consisting of a short-term capital gain of   
$1,000 and a long-term capital gain of $1,000. When you prepare a corrected return   
(to include the capital gain income), what is the amount of the increase in their income   
tax liability before credits on a joint federal income tax return for the current year?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $150 | **b.** | $300 | **c.** | $400 | **d.** | $500 | **e.** | Other | **C** |

Sherri began investing in stock in 2013, and made her first sale in 2016.   
For 2016, Sherri has a short-term loss of $2,500 and a long-term loss of $4,000.   
How much loss will Sherri carryover to 2017 and what is the character of the loss carryover?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | $3,500 Long-term | **b.** | $3,500 Short-term | **c.** | $2,500 Short-term & $1,000 Long-term | **A** |

An individual had salary income and capital gains and losses as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Tax Year:** | **2015** | **2016** | **2017** |
| Salary | $120,000 | $120,000 | $120,000 |
| Long-term capital gain | $14,000 | $2,000 | $0 |
| Short-term capital loss | ($18,000) | ($3,000) | $0 |

She has no deduction for AGI, other than capital losses. What is her adjusted gross income for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $120,000 | **b.** | $119,000 | **c.** | $118,000 | **d.** | $117,000 | **e.** | Other | **C** |

|  |  |
| --- | --- |
| **Sales to Related Parties, Wash sales** | **[19]** |

Courtney earns a salary of $100,000 per year.

Courtney purchased 100 shares of Cisco stock in 2012 for $50 a share.

On December 21, 2016, Courtney sold all of the Cisco stock for $40 a share.

Later, Courtney decided that Cisco might be a good long-term investment.

On January 3, 2017 (13 days later), she bought 100 shares of Cisco stock for $41 a share ($4,100).

How much loss may she deduct on her income tax return for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Zero | **b.** | $500 | **c.** | $1,000 | **d.** | $600 | **e.** | other | **A** |

What is Courtney’s total basis in the Cisco stock that she bought in 2015?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $1,640 | **b.** | $2,040 | **c.** | $2,080 | **d.** | $5,100 | **e.** | other | **D** |

**[Pg. 5-19]** Ms. Rich had the following transactions in GM Corp. common stock.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Asset** | **Date** | **Transaction, etc.** | **Number** | **Description** | **Amount** |
| GM stock | 1-2-2005 | Bought: | 4,000 shares | Total Cost | $20,000 |
| GM stock | 12-31-2016 | Sold: | 4,000 shares | Total Selling Price | $12,000 |
| GM stock | 1-2-2017 | Bought: | 3,000 shares | Total Cost | $9,000 |

How much loss may she deduct for 2016 and what is the basis of the stock bought in 2017?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Loss** | **Basis** |  |  | **Loss** | **Basis** |  | **D** |
| **a.** | $2,000 | $9,000 |  | **c.** | $0 | $15,000 |
| **b.** | $0 | $9,000 |  | **d.** | $2,000 | $15,000 |

**[Pg. 5-19]** Heinrich owned 1,000 shares of Vanity Corp. common stock, which he bought   
two years ago for $4,000. On December 29, 2014, Heinrich sold all of his shares for $2,500.   
On January 23, 2015, he purchased 600 shares of Vanity Corporation common stock.   
What is the amount of Heinrich's recognized loss in 2014?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $ 600 | **c.** | $ 900 | **d.** | $1,500 | **e.** | $4,000 | **B** |

**In April**, **Pam** sold stock with a basis of $15,000 to **Lisa** (her sister) for $10,000 (it’s FMV).   
Later, **Lisa** sold the stock to her neighbor, **Niki**, for $8,000. How much loss does **Pam** deduct?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $2,000 | **c.** | $5,000 | **d.** | $7,000 |  | **A** |

**In April, Pam** sold stock with a basis of $15,000 to **Lisa** (her sister) for $10,000 (it’s FMV).   
Later, **Lisa** sold this stock to her neighbor, **Niki**, for $16,000. How much gain does **Lisa** report?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $6,000 | **b.** | $5,000 | **c.** | $1,000 | **d.** | $0 |  | **C** |

|  |  |
| --- | --- |
| **Other income, Flow-through Entities** | **[20]** |

**[Pg. 5-21]** Which entity is required to pay federal income tax on its taxable income?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Sole Proprietorship. | **b.** | Partnership. | **c.** | S Corporation. | **d.** | C Corporation. |  | **D** |

**[Pg. 5-21]** Wendy owns 20% of the common stock of Britton Company.   
Wendy does not receive a salary from Britton.   
In the current year, Britton reported a taxable income of $90,000 and paid $40,000 in cash dividends.   
at are the income tax effects for Wendy of her investment in Britton Company?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Tax Treatment** | **If an S or C Corporation** |  | | | **A** |
| **a.** | $8,000 | If Britton is a C Corporation | |  |
| **b.** | $8,000 | If Britton is an S Corporation | |  |
| **c.** | $26,000 | If Britton is an S Corporation | |  |
| **d.** | $26,000 | If Britton is an S Corporation | |  |

**[Pg. 5-21]** Barbara earns a salary from Big Corporation of $100,000 per year.   
She is also a 25% partner in a partnership that owns rental property.   
During the year, the partnership had revenue of $90,000 and expenses of $50,000.   
No salary or guaranteed payment was made to any partner.   
Barbara did withdraw $4,000 from the partnership during the year.   
What is Barbara’s adjusted gross income, assuming she has no deduction “for AGI?”  
(Do not consider the deduction for half of self-employment tax paid.)

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $100,000 | **b.** | $104,000 | **c.** | $110,000 | **d.** | $114,000 | C |

**[Pg. 5-21]** Jan is the only shareholder of two corporations that she started on January 1, 2016:   
(1) Computer Repair Corporation and (2) Web Consulting Corporation. She elected S status for Web   
Consulting Corporation. Income statements for these two corporations are shown below for 2016.

|  |  |  |
| --- | --- | --- |
|  | **Computer Repair** | **Web Consulting** |
|  | **[C Corp]** | **[S Corp]** |
| Revenue | $100,000 | $200,000 |
| Salary to Jan (owner) | (30,000) | (80,000) |
| Rent expenses | (20,000) | (70,000) |
| Other expenses | (10,000) | (10,000) |
| Net income before taxes | $40,000 | $40,000 |
| Dividends paid to Jan | $10,000 | $10,000 |

How much total income does Jan report from these two entities?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $110,000 | **b.** | $160,000 | **c.** | $170,000 | **d.** | $210,000 | **e.** | Other | **B** |

Also, what is the ending balance in retained earnings of Computer Repair Corporation? \_\_\_\_\_\_\_

Also, Jan’s basis in the stock of the Web Consulting Corporation at the end of the year? \_\_\_\_\_\_

|  |  |
| --- | --- |
| **Alimony, Prizes, Gambling Income, etc.** | **[21: 61]** |

**[Pg. 5-23]** Paula received a $10,000 award for outstanding civic achievement from the local   
Chamber of Commerce. Paula was selected without any action on her part, and no future   
services are expected of her as a condition of receiving the award. Paula gave $4,000 of   
it to the United Way.   
How much should Paula include in her AGI in connection with this award?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $ 4,000 | **c.** | $ 6,000 | **d.** | $10,000 | CPA adapted | **C** |

**[Pg. 5-21]** In the current year, Jane received the following monthly amounts   
(for 12 months) from her former husband, as required by their 2014 divorce agreement:   
**(1)** alimony of $5,000 per month and   
**(2)** child support of $2,000 per month for their six-year old child.   
She also received stock worth $100,000.   
This is her only income. How much is her AGI?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $ 60,000 | **c.** | $ 84,000 | **d.** | $184,000 |  | **B** |

|  |  |
| --- | --- |
| **Social Security Benefits** | **[24]** |

**[Pg. 5-24]** Joe is married and files a joint return with Sue. They receive Social Security   
benefits of $10,000 per year. They also received dividends from investments of $10,000 and   
municipal bond interest of $32,000 per year. How much of his Social Security benefits are   
included on their income tax return for the current year?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $ 12,000 | **c.** | $ 18,000 | **d.** | $8,500 | **e.** | Other | **D** |

**Note: Social Security computations can be complex. The instructor will only ask simple questions.**

|  |  |
| --- | --- |
| **Bargain purchase or loan** | **[26]** |

**[Pg. 5-26]** Which of the following loans requires that interest be imputed?

|  |  |  |
| --- | --- | --- |
| a. | An interest free loan of $8,000 by a father to his daughter | **C** |
| b. | An interest free loan of $80,000 by a father to his son who has investment income of $500. |
| c. | An interest free loan of $80,000 by a father to his son who has investment income of $5,000. |

**[Pg. 5-26]** Big Bank owns several condos in Charlotte that are used by out-of-state employees   
who come to Charlotte for training or temporary work assignments. John, who was recently   
transferred permanently to Charlotte, accepted Big Bank’s offer to sell one of the condos to John.   
The bank had paid $200,000 for the condo, which had a current appraised value of $300,000.   
John bought the condo from Big Bank for $220,000.   
How much income does John report on this transaction?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $20,000 | **b.** | $60,000. | **c.** | $80,000 | **d.** | $100,000 |  | **C** |

|  |  |
| --- | --- |
| **Municipal Interest Income** | **[29]** |

**[Pg. 5-29]** John, a single taxpayer, received interest income of $40,000 consisting of:

|  |  |
| --- | --- |
| Certificate of deposit | $6,000 |
| Savings account interest | 4,000 |
| City of Charlotte Bond interest | 8,000 |
| Mortgage note | 12,000 |
| Mecklenburg County bond interest | 7,000 |
| Corporate bond interest | 3,000 |

What is the amount of taxable interest income he will report on his Form 1040?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $25,000 | **c.** | $19,000 | **d.** | $33,000 | **e.** | Other |  | **B** |

Dawn will invest $100,000 in bonds: either Duke Energy bonds that pay interest   
at the rate of 5%, or City of Charlotte bonds that pay interest at the rate of 3.5%.   
Dawn is in the 25% federal income tax bracket. There is no state income tax.   
To maximize the current after-tax interest income, Dawn should invest in bonds issued by:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | Duke Energy | **b.** | City of Charlotte | **c.** | Both provide same after tax return | **A** |

Use information in preceding question. At what marginal income tax rate   
would Dawn be indifferent at to which bonds to choose for investment?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 0% | **b.** | 15% | **c.** | 25% | **d.** | 30% | **e.** | 33% | **D** |

Use information in question no. 40, except assume there is a 10% state income tax imposed on individuals. To maximize the current after-tax interest income, Dawn should invest in bonds of:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Duke Energy | **b.** | City of Charlotte | | | **c.** | Both provide same after-tax return | **B** |
| **Gain on Sale of Residence** | | | | **[29,30]** |

Shantel owned and lived in a home for five years before marrying Daron. Shantel and Daron   
lived in the home for two years before selling it at a $700,000 gain. Shantel was the sole owner   
of the residence until it was sold. How much of the gain may Shantel and Daron exclude?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $250,000 | **c.** | $500,000 | **d.** | $700,000 | **e.** | Other | **C** |

**Because Shantel meets the ownership test and both Shantel and Daron meet the use test requirement, the couple may exclude $500,000 of gain. Learning Objective: 14-02. Compute   
the taxable gain on the sale of a residence and explain the requirements for excluding gain.**

Larry owned and lived in a home for five years before marrying Darlene. Larry and Darlene   
lived in the home for one year before selling it at a $600,000 gain. Larry was the sole owner   
of the residence until it was sold. How much of the gain may Larry and Darlene exclude?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $250,000 | **c.** | $500,000 | **d.** | $600,000 | **e.** | Other | **B** |

**Because Darlene didn't meet the two-year use test, the couple qualifies for the $250,000   
exclusion not the $500,000 exclusion. Learning Objective: Compute the taxable gain on   
the sale of a residence and explain the requirements for excluding gain on the sale.**

|  |  |
| --- | --- |
| **Fringe Benefits. (Group-term Insurance** 26 CFR 1.79-3) | **[29: 69]** |

In a recent year, 19 million taxpayers received W-2 forms indicating that they had received   
more than $50,000 of group-term life insurance which was provided by their employers.   
They reported $6 billion in extra income as a result of this coverage, so it is important. See next table.



Grace's employer provides each employee with $200,000 of group-term life insurance.   
Grace (age 51) received the coverage for the entire year. Grace's employer pays premiums   
of $700 each year to provide this coverage for Grace. How much income will be reported   
on her W-2 form for this group-term life benefit? (See table above.)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $180 | **c.** | $264 | **d.** | $414 | **e.** | Other | **D** |

Which of the following is not a requirement of a "qualified employee discount"?

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| a. | The discount relates to goods or services of the employer. | | | **C** |
| b. | | The discount on services doesn't exceed 20 percent of the price offered to customers. |
| c. | | The discount can be elected up to five times annually. |
| d. | | The employee discount on goods is not greater than employer's average gross profit. |

**[Pg. 5-31] [Sec. 132(a)(4)]** Michael coaches a little league baseball team.   
He made 15 copies of the team’s schedule (to give to the players) on his employer’s copier  
(with his employer’s consent). Michael does not include the cost of the copies in his income.   
The applicable fringe benefit exclusion is referred to as the

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **a.** | De minimis exception. | **b.** | No additional cost rule. | | **A** |
| **c.** | Qualified employee discount rule. | **d.** | Capital Recovery Concept. |
| **e.** | Pay-as-You-Go Concept. |  |  |

**[Pg. 5-31]** Ann earned a salary of $40,000 from Big Bank. Ann also received:   
**(1)** medical insurance costing the Big Bank $8,000 and   
**(2)** child care worth $4,000 for her 3-year-old child at the on-site Big Bank child care center.   
Ann was among the top executives in getting new business.  
She received a check for $1,000 Myrtle Beach Golf Weekend, paid for by Big Bank.   
What is the amount of gross income that Ann will report for her work for Big Bank?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $53,000 | **b.** | $45,000 | **c.** | $41,000 | **d.** | $40,000 |  | **C** |

**[Pg. 5-31]** Bill is the night manager at the Shady Arms motel.   
He is provided a room at the motel, free of charge.

He is not required to stay at the motel as a condition of employment.   
The fair rental value of this room was $4,400.   
Nix estimates that living elsewhere would have cost at least $5,200.   
Bill must report gross income of:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $800. | **c.** | $4,400 | **d.** | $5,200. |  | **C** |

**[Pg. 5-31]** Big Utility requires executives to travel to power generating plants in the state   
on a regular basis. Each executive is provided a company auto. The auto is only used for company   
business travel or transportation. Sue’s company auto is leased by Big Utility for $5,000 per year   
and the company spends $4,000 on fuel and operating costs. If Sue were to lease the same auto,  
 she would have to incur lease payments of $6,000 and her fuel would cost $500 more at retail   
stores. How much income is reported by Sue for the auto?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $5,000. | **c.** | $9,000 | **d.** | $10,500 |  | **A** |

**[Pg. 5-31]** Harry is a CPA employed as a manager by an accounting firm. The firm pays Harry's   
dues of $200 to professional organizations and pays $250 monthly ($3,000 per year) for his personal parking place at the office. How much income is reported by Harry for these items? (page 4-12)

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $200. | **c.** | $1,620 | **d.** | $1,820 |  | **A** |

**[Pg. 5-31]** Susan earns a salary of $40,000 per year. The employer provides hospitalization   
insurance for employees, but not dental insurance. Under the company’s qualified cafeteria   
plan, Susan was entitled to choose up to $4,000 of fringe benefits not otherwise covered   
by the employer. She chose to receive a $3,000 dental insurance policy and received   
a check for the $1,000 balance in her $4,000 allowance. What is her adjusted gross income?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $41,000 | **c.** | $43,000 | **d.** | $54,000 |  | **B** |

**[Pg. 5-31]** All of these fringe benefits paid for by the employer may be   
excluded from an employee's gross income except

|  |  |  |  |
| --- | --- | --- | --- |
| **a.** | Membership fees in professional organizations. |  | **D** |
| **b.** | Recreational facilities |  |
| **c.** | Unused airline seats for airline employees where employee is required to fly "standby." |  |
| **d.** | Discounts on services up to 50 percent. |  |
| **e.** | None of the above is required to be included in the employee's gross income. |  |

**[Pg. 5-31]** Joey's employer establishes Health Savings Accounts (HSA’s) for its employees.   
The plan provides for his employer to pay $1,000 into Joey's HSA, and Joey to also contribute   
$1,000 to his HSA. During the year, the plan pays for $1,500 of Joey’s medical expenses not   
covered by the employer’s regular medical insurance plan.

|  |  |  |  |
| --- | --- | --- | --- |
| I. | Joey must include the $1,000 contribution by his employer in his gross income. | | |
| II. | The $500 still in the account at the end of the year carries forward to the next year. | | |
| **a.** | Only statement I is correct. | | |  | | | **B** |
| **b.** | Only statement II is correct. | | |  |
| **c.** | Both statements are correct. | | |  |
| **d.** | Neither statement is correct. | | |  |

|  |  |
| --- | --- |
| **Scholarship, 529 Plan, Coverdale, EE Bonds** | **[32]** |

**[Pg. 5-32]** Clyde is a degree candidate at a local college. During the fall semester he received a $3,000 scholarship from a local foundation. Clyde spent the entire $3,000 and another $1,500 from   
a student loan during this semester. He paid the following expenses: tuition $2,000, books $500,   
and room and board $2,000. How much of the $3,000 scholarship should Clyde report as income?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $500 | **b.** | $-0- | **c.** | $3,000 | **d.** | $1,000 |  | **A** |

**[Pg. 5-32]** Mary is a degree candidate at State University.   
In February, Mary applied for a scholarship and received $9,500 for the fall semester.

The scholarship will pay $6,500 for tuition, $600 for books and fees of $400.   
Mary will serve as a tutor for a few hours a week for $2,000.   
Mary's taxable income from the scholar­ship is:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $-0- | **b.** | $2,000 | **c.** | $3,000 | **d.** | $9, 500 |  | **B** |

|  |  |
| --- | --- |
| **Gifts/Inheritance. Life Insurance proceeds.** | **[33: 74, 81]** |

**[Pg. 5-33]** On March 1, 2016, Lois Rice inherited 1,000 shares of Elin Corp. stock under   
the will of her uncle, Pat Prevor. Pat Prevor had paid $5,000 for the Elin stock in 2001.   
FMV of the Elin stock on March 1, 2016, the date of Pat's death, was $8,000. FMV was $11,000 six months later. The executor of Pat's estate did not elect the alternate valuation date (for all assets   
in the estate) for estate tax purposes. Lois sold the Elin stock for $9,000 on May 1, 2017.   
How much should Lois include in her income on her 2016 individual income tax return for the inheritance?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0. | **b.** | $5,000. | **c.** | $8,000 | **d.** | $11,000. | **e.** | $1,000. [CPA Exam] |  | **A** |

**[Pg. 5-13]** Mrs. Jones, a widow whose husband died in November 2012, chose to receive the pro­ceeds of her husband's $150,000 life insurance policy in twenty yearly installments of $10,000 each.   
How much of each pay­ment is interest income to be included in Mrs. Green's gross income in 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $1,500 | **b.** | $2,500 | **c.** | | $5,000 | | **d.** | Other | **B** |
| **Foreign earned income** | | | | | **[35]** | |

**[Pg. 5-35]** Sara applies for and receives a work assignment in England for Big Corp.   
She moved to London on 1-1-2015. She worked and lived there continuously until the middle   
of 2016, when she returned to the U.S. Her salary is $200,000 per year, in both 2015 and 2016.   
The maximum annual exclusion is computed on a daily basis, for each day in the taxable year   
that the individual was in the foreign country.   
What is the amount of her foreign earned income exclusion for 2016 (Approximate amount)?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $50,650 | **c.** | $60,000 | **d.** | $97,600 |  | **B** |

|  |  |
| --- | --- |
| **Sickness and Injury Exclusions.** | **[36]** |

**[Pg. 5-36]** In 2016, a speeding driver failed to stop at an intersection and   
injured Joe. Joe lost 25% use of his right arm, and incurred $3,000 of medical expenses.   
In a lawsuit, a court awarded Joe $3,000 for medical expenses, $75,000 for the disability,   
and $22,000 punitive damages. He collected all of these amounts during 2016.   
(All of these events occurred in 2016.)  
How much of these amounts should Joe report as gross income for 2016?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $100,000 | **b.** | $97,000 | **c.** | 75,000 | **d.** | $22,000 | **e.** | $0 |  | **D** |

**[Pg. 5-36]** Juan was injured at work in December, 2015 and was unable to work for the   
first two months in 2016. During that time, he received workers’ compensation payments   
of $5,000. On March 1, 2016, he returned to work and earned a salary of $5,000 per month   
for 6 months (total $30,000). Unfortunately, his position was eliminated and he was out   
of work for the last 4 months of 2016. During that time, he received unemployment   
compensation of $4,000. What is his gross income for 2016?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $30,000 | **b.** | $34,000 | **c.** | 35,000 | **d.** | $39,000 | **e.** | Other |  | **B** |

|  |  |
| --- | --- |
| **Employer Retirement Plan-Early W/D Penalty** | **[38, 40: 84]** |

**In a recent year, 32 million tax returns showed that taxpayers received w-2 forms indicating   
that they had deferred $161 billion in earnings, because they asked the employers to   
invest those earnings in a 401(k) plan.**

Randy earns a salary of $50,000 at Big Corporation. Randy elected to contribute $5,000   
to the corporate 401(k) plan. The company matched the gift at the rate of 50%. Randy   
received a 401(k) statement at the end of the year indicating that his year-end balance   
is $7,500 (his contribution, plus the employer match). What is Randy’s gross income   
from his employment with Big Corporation for the current year?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $52,500. | **b.** | $50,000. | **c.** | $47,500. | **d.** | $45,000. | **e.** | Other |  | **D** |

Shauna received a $100,000 distribution from her 401(k) account this year.   
Shauna's marginal tax rate is 25%. She has not yet retired.

Shauna received the distribution on her 57th birthday.

What is the total amount of tax and penalty Shauna will be required to pay?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0. | **b.** | $10,000. | **c.** | $25,000. | **d.** | $35,000. | **e.** | Other |  | **D** |

**She must pay $25,000 of income tax on the distribution and a 10% early distribution penalty   
because she was not 59 ½ on the date of the distribution and she had not yet retired.**

|  |
| --- |
| **Unemployment compensation is taxable** |

**[Pg. 5-36]** Which of the following receipts are fully taxable?

|  |  |  |  |
| --- | --- | --- | --- |
| **a.** | Social security benefits |  | **C** |
| **b.** | annuity benefits from policy purchased by taxpayer |  |
| **c.** | unemployment benefits |  |
| **d.** | The value of coverage under $100,000 group-term life insurance program, where  employer pays all premiums, and employee's family members are beneficiaries. |  |

**[Pg. 5-28]** Joe earned a salary of $5,000 per month for six months in 2015. In the last six   
months of 2015, he was unemployed and received unemployment compensation of $15,000.   
He charged many expenses on his credit cards and ran up a balance of $6,000.   
He negotiated with the credit card company a deal in which he paid $2,000 of the $6,000 balance.

Under the agreement, the credit card company forgave the rest.   
How much is his gross income for 2015?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $30,000 | **b.** | $34,000 | **c.** | $45,000 | **d.** | $49,000 | **e.** | Other |  | **D** |