**CHAPTER 1-INTRODUCTION- Use 2016 tax law.**

|  |
| --- |
| **Chapter 1. An Introduction to Tax****Nature of tax (2)****Tax Base, Calculate Tax, Marginal-average-effective tax rates (5)****Tax rate structures: proportional, progressive, regressive, etc. (9)****Federal taxes, state taxes, implicit taxes,** **Municipal-Bonds: Investment alternatives (17)****Evaluate a tax [static, substitution, equity], Equity, Adam Smith (17+)****Apply Skills from Past Accounting Courses, Combination of topics** |

**Nature of tax (2)**

Which of the following is not a tax?

|  |  |  |
| --- | --- | --- |
| **a.** | Amount added to price of gasoline to cover cost of building and repairing highways |  |
| **b.** | Taxes added to cost of buying everyday items in retail stores |
| **c.** | Citation received for speeding on highways |
| **d.** | Taxes paid on value of home |

**Tax Base, Calculate Tax, Marginal-average-effective tax rates (5)**

Sue who is single, claims one exemption and has itemized deductions of $7,000.
She had no deduction for AGI. Her salary was $100,000. Compute her income tax for 2016.
What is her average tax rate, using this information (use closest answer)?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 21.3% | **b.** | 20.25% | **c.** | 25% | **d.** | 16% |  |  |  |

 If a taxpayer has a choice of receiving income in the current year or next year, which of the following tax rates is important in determining the year in which he should include the income?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Average. | **b.**  | Effective. | **c.** | Composite. | **d.** | Marginal. |  |

Jenny is single and has a 2016 taxable income of $200,000.
She also received $15,000 of tax-exempt income. Jenny's marginal tax rate is:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 22.9% | **b.** | 24.9% | **c.** | 25.0% | **d.** |  28.0% | **e.** | 33.0% |  |

Jenny is single and has a 2016 taxable income of $200,000.
She also received $15,000 of tax-exempt income. Jenny's average tax rate is:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 22.909% | **b.** | 24.765% | **c.** | 25.0111% | **d.** |  28.099% | **e.** | 33.0% |  |

Jenny is single and has a 2016 taxable income of $200,000.
She also received $15,000 of tax-exempt income. Jenny's effective tax rate is:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 23.037% | **b.** | 24.765% | **c.** | 25.099% | **d.** |  28.012% | **e.** | 33.0% |  |

Which of the following is not a deduction for adjusted gross income?

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | Trade or business expenses | **b.** | Interest on student loans |  |
| **c.** | Rental expenses | **d.** | Investment interest |

 Bill is single and claims one exemption. There is no income tax in his state.
He reports the following income and disbursements for 2016.

|  |  |
| --- | --- |
| Salary | $100,000 |
| Property tax paid by Bill on home | 1,000 |
| Charitable contribution made by Bill (in cash) | 3,000 |
| Alimony paid by Bill to former spouse | 30,000 |

What is Bill’s adjusted gross income?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $100,000 | **b.** | $70,000 | **c.** | $69,000 | **d.** | $66,000 |  |

 Repeat preceding question. What is Bill’s taxable income for 2016?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $60,000 | **b.** | $62,200 | **c.** | $59,650 | **d.** | $65,000 |  |

 Beth’s taxable income was $75,000. She is single.
What is Beth’s tax liability for 2016 before considering withholding and other credits?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $14,521 | **b.** | $13,233 | **c.** | $16, 409 | **d.** | $20,000 |  |

 Based on the following information, what is the 2016 taxable income on a joint
return for a married couple with no children or other dependents?

|  |  |
| --- | --- |
| Total income | $106,900 |
| Excludable income | 900 |
| Deductions for AGI | 5,000 |
| Allowable actual itemized deductions |  7,200 |
| **a.** | $75,900 | **b.** | $80,300 | **c.** | $86,800 | **d.** |  $87,800 | **e.** | $91,300 |  |

**Tax rate structures: proportional, progressive, regressive, etc. (9)**

**Federal taxes, state taxes, implicit taxes,**

How much additional Social Security tax and Medicare tax does Elise pay in 2016 on
her $10,000 Christmas bonus? (Her total salary for the year was $110,000, before the bonus.)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $672 | **c.** | $620 | **d.** | $765  |  |  |  |

An employer pays Joe a salary of $50,000 in 2016. (There is no state income tax.)
The employer withholds FICA and matches it when making its deposit of payroll taxes to the IRS.
The employer also withholds federal income tax of $5,000 and pays combined FUTA and SUTA
of $434. What is the employer’s total deduction for compensation and payroll taxes for Joe?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | $54,245 | **b.** | $59,259 | **c.** | $58,084 |  |

Who pays FUTA?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | Employers | **b.** | Employees | **c.** | Both |  |

**Municipal-Bonds: Investment alternatives (11)**

 Jackson has the choice to invest in city of Boone bonds or IBM, Inc. corporate bonds
that pay 10% interest. Jackson is a single taxpayer who earns $50,000 annually.
Assume that the city of Boone bonds and the IBM, Inc. bonds have similar risk.
What interest rate would the city of Boone have to pay in order to make Jackson
indifferent between investing in the city of Boone and the IBM, Inc. bonds for year 2016?

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** |

|  |
| --- |
| 7.50% |

 | **b.** |

|  |
| --- |
| 10.00% |

 | **c.** |

|  |
| --- |
| 8.00% |

 | **d.** |

|  |
| --- |
| 7.20% |

 | **e.** | Other |  |

 **[Pg. 1-17, 5-28]** Sue owns $100,000, 6% City of Concord bonds that pay interest
of $3,000 on June 30 and December 31. Sue is in the 20% marginal tax bracket.
What rate is needed on a taxable bond to provide the same after-tax return?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 4.5 %  | **b.**  | 6 %  | **c.** | 7 % | **d.** | 7.5% | **e.** | 8% |  |  |

 **[Pg. 1-17, 5-28]** An investor owns municipal bonds having a cost, par value, and a fair
market value of $200,000. These bonds pay interest at the rate of 6%. A friend has
suggested that the investor sell these bonds and invest in high grade corporate bonds.
The investor is in the 35% federal marginal tax bracket. (Ignore impact of state income taxes)
What return would this investor have to earn on corporate bonds in order to be just as
well off as he is now with the municipal bonds?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 6%  | **b.**  | 7.685%  | **c.** | 8.333%  | **d.** | 9.231%  | **e.** | 10.4% |  |  |

**Evaluate a tax [static, substitution, equity], Equity, Adam Smith (17)**

Which of the following is not included among Adam Smith's criteria for evaluating a tax?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Convenience. | **b.** | Equality. | **c.** | Neutrality | **d.** | Economy.  | **e.** | Certainty |  |

When planning for an investment that will extend over several years, the ability to predict
how the results of the investment will be taxed is important. This statement is an example of

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Convenience. | **b.** | Equality. | **c.** | Neutrality | **d.** | Economy.  | **e.** | Certainty |  |

The concept of diminishing marginal utility is associated with:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Horizontal equity | **b.** | Vertical equity | **c.** | Both | **d.** | Neither |  |  |  |

Consider the case of Sam and Sue. Both are single, claim one exemption and
have itemized deductions of $20,000. Assume we compute Sam’s income tax on
his salary was $70,000. We also compute Sue’s tax on her salary of $120,000.
When we compare the tax for Sam and Sue, our analysis is associated with:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Horizontal equity | **b.** | Vertical equity | **c.** | Both | **d.** | Neither |  |  |  |

**Apply Skills from Past Accounting Courses, Combination of topics**

**The following information is used for the remaining questions in this homework.
Small Company had this (GAAP) trial balance at the end of its first year (2016).
The home repair company (a proprietorship) uses the accrual method.
Please download Form 1040 and schedule C from IRS.gov.
(Some questions provide a review of important GAAP accounting rules from Intermediate Acct.)**

|  |  |  |  |
| --- | --- | --- | --- |
| Cash |   | 20,000 |   |
| Accounts Receivable |   | 70,000 |   |
| Equipment-placed in service January 2, 2016 |   | 50,000 |   |
| Accumulated Depreciation-Straight Line- 5 years |   |   | 10,000  |
| John Small, Capital |   |   | 90,000  |
| Home repair revenue |   |   | 200,000  |
| Rent expense on business property |   | 20,000 |   |
| Advertising expense |   | 7,000 |   |
| Depreciation expense |   | 10,000 |   |
| Employee salaries, payroll taxes, and other expenses |   | 123,000 |   |
| Totals |   | 300,000 | $300,000  |

Assume all business expenses (above) are fully deductible in compliance with the tax law.Mr. Small is single, 40 years of age, with no dependent. He claims the standard deduction. He does not have an office (for his business) in his home. His repair business above is his only source of income, other than a bank savings account that provides interest income for Mr. Small in the amount of $12,000 annually. He has no deductions other than the standard deduction, his exemption and his business deductions for his repair business, identified above. Mr. Small lives and works in a state that does not have an income tax. To simplify this problem, do not claim the deduction for 50% of self-employment tax.

Use the income tax rates and other tax law for 2016.
Class web page: ***T***[***16F-Chap-00-Portrait-Tax-Rates-Sept-25-2016***](https://belkcollegeofbusiness.uncc.edu/hgodfrey/wp-content/uploads/sites/875/2014/11/T16F-Chap-00-Portrait-Tax-Rates-Sept-25-2016.pdf)

What amount will be reported on line 31 of Schedule C for Form 1040?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $40,000 | **c.** | $50,000 | **d.** | $60,000 | **e.** | Other |  |

What amount will be reported on line 37 on page 1 of Form 1040?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $40,000 | **c.** | $52,000 | **d.** | $60,000 | **e.** | Other |  |

What amount will be reported on line 40 on page 2 of Form 1040?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $6,300 | **b.** | $11,900 | **c.** | $8,700 | **d.** | $2,000 | **e.** | Other |  |

Mr. Small made estimated federal income tax payments of $7,000 in 2016.
What is the amount of his income due, or (refund) for 2016? (Nearest amount)

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | None | **b.** | $907 | **c.** | ($816) | **d.** | ($2,200) | **e.** | Other |  |

 What is his marginal income tax bracket?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 10% | **b.** | 15% | **c.** | 25% | **d.** | 28% | **e.** | Other |  |

The other expense amount above includes salaries of $30,000 each, for 2 employees.
How much total social security taxes (employee and employer portion) will be paid to the IRS?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $9,180 | **b.** | $6,920 | **c.** | $7,423 | **d.** | $5,980 | **e.** | Other |  |

The other expense amount above includes salaries of $30,000 each, for 2 employees.
The company qualifies for the maximum credit (5.4%) for state unemployment tax.
How much total federal unemployment tax will be paid to the IRS?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $412 | **b.** | $84 | **c.** | $222 | **d.** | $912 | **e.** | Other |  |

**Refer to the basic information above. Ignore questions 22 through 28.**

What is the ending capital balance on the balance sheet prepared on 12-31-2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $200,000 | **b.** | $130,000 | **c.** | $20,000 | **d.** | $230,000 | **e.** | Other |  |

If the business is a C corporation, how much corporate tax is owed for 2016?

Use regular corporate tax rates.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $37,850 | **b.** | $35,000 | **c.** | $40,555 | **d.** | $6,000 | **e.** | Other |  |

Continue to assume the business is a C corporation. Use regular corporate tax rates.
The corporation elects (in accordance with the tax law) to write off the entire cost
of the equipment on the tax return. How much tax will be saved with this election?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $14,250 | **b.** | $19,500 | **c.** | $6,000 | **d.** | $15,000 | **e.** | Other |  |

Continue to assume the business is a corporation. The corporation elects (in accordance with
the tax law) to write off the entire cost of the equipment on the tax return. The company issues audited financial statements prepared in accordance with GAAP. The company expects to be in
the same income tax bracket in future years. In the journal entry to record the provision for
income tax at the end of 2016, what is the amount of the credit to current income tax liability?
Use regular corporate tax rates.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $6,000 | **c.** | $4,000 | **d.** | $3,000 | **e.** | Other |  |

Continue to assume the business is a corporation. Use regular corporate tax rates.
The corporation elects (in accordance with the tax law) to write off the entire cost of the
equipment on the tax return. The company issues audited financial statements prepared in accordance with GAAP. The company expects to be in the same income tax bracket in
future years. What is the balance in the deferred tax asset or liability at the end of 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $6,000 | **c.** | $4,000 | **d.** | $3,000 | **e.** | Other |  |

Continue to assume the business is a corporation. The corporation elects
to write off the entire cost of the equipment on the tax return.
The company issues audited financial statements prepared in accordance with GAAP.
The company expects to be in the same income tax bracket in future years.
Is the deferred tax account an asset or a liability at the end of 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Asset | **b.** | Liability | **c.** | Neither | **d.** | Other |  |  |  |

Continue to assume the business is a corporation. The corporation elects to write
off the entire cost of the equipment on the 2016 tax return. Use regular corporate tax rates.

The company issues audited financial statements prepared in accordance with GAAP.
The company expects to be in the same income tax bracket in future years.
What is the balance in the deferred tax asset or liability at the end of 2018?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $6,000 | **c.** | $4,000 | **d.** | $3,000 | **e.** | Other |  |

Continue to assume the business is a corporation. The corporation elects to
write off the entire cost of the equipment on the tax return. The company
issues audited financial statements prepared in accordance with GAAP.
In 2018, congress has amended the tax law and the company will be in
the 25% tax bracket in 2018 and 2019.

What is the balance in the deferred tax asset or liability at the end of 2018?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $5,000 | **b.** | $6,000 | **c.** | $4,000 | **d.** | $3,000 | **e.** | Other |  |