Appendix C

Concept Check Answers

CHAPTER 1

Concept Check 1-1

1. Progressive, proportional, regressive.
2. Proportional.
3. Progressive.

Concept Check 1-2

1. True.
2. 25%. For a married couple, the marginal rate is 25% for taxable income between $75,900 and $153,100.
3. False. The average tax rate is the percentage that a taxpayer pays in tax given a certain amount of taxable income. The marginal tax rate represents the proportion of tax that he or she pays on the next dollar of taxable income.
4. False. All tax returns conform to the basic formula.

Concept Check 1-3

1. False. Only taxpayers with a simple tax structure who meet six criteria can file Form 1040EZ.
2. False. To file Form 1040EZ, a taxpayer must be under age 65.
3. True. With the fact pattern provided, Erma meets the six criteria and can file Form 1040EZ.

Concept Check 1-4

1. Wages, unemployment compensation, and interest. The category wages includes salary and tips.
2. Form 1099-G.
3. Single, married filing jointly.

Concept Check 1-5

1. True. Taxpayers must use the tax tables if their income is under $100,000. If taxpayers are eligible to use Form 1040EZ, they must have income under $100,000 (otherwise they would not be eligible to use the form).
2. $14,796.
3. $14,793.
4. False. The payment is the greater of 2.5% or a flat dollar amount based on the number of family members.

Concept Check 1-6

1. False. Taxpayers pay an estimate of their tax liability during the year with income tax withholdings or quarterly estimated tax payments.
2. Required to pay, $392.
3. False. An Earned Income Credit is subtracted from the tax liability.

Concept Check 1-7

1. Ways and Means.
2. The Internal Revenue Code.
3. True. For any action to become law, both houses of Congress and the president must agree.

Concept Check 1-8

1. False. Statutory tax authority (the law) takes precedence over all other types of tax authority.
2. False. Revenue Procedures are issued by the IRS for use by all taxpayers.
3. IRS Treasury Regulations. See Table 1-6.

Concept Check 1-9

1. False. Tax cases can be appealed to the U.S. Supreme Court.
2. False. The taxpayer can file a suit with the Tax Court, the district court, or the Court of Federal Claims.
3. Tax. The advantage of using the Tax Court is that the taxpayer does not need to pay the IRS's proposed assessment prior to trial.

CHAPTER 2

Concept Check 2-1

1. False. A taxpayer should use the simplest form that is appropriate for his or her situation. This approach will save the taxpayer and the IRS time and money.
2. True. Adjusted Gross Income (AGI) is an important concept because several deductions and credits depend upon the AGI amount. Some examples are the medical deduction and the Earned Income Credit.

Concept Check 2-2

1. True. Yes, couples in the process of obtaining a divorce (where the divorce is not yet final) can file a joint return.
2. True. The social security number and full name of the spouse must be shown on the return.
3. False. The surviving spouse must also meet another rule that states the household needs to be the principal place of abode for the entire year (except for temporary absences) of both the taxpayer and a child, stepchild, or adopted child who can be claimed as a dependent by the taxpayer.

Concept Check 2-3

4. True. The amount of the personal exemption is $4,050 for 2017. On a joint return, the taxpayer is entitled to two personal exemptions: one exemption for himself or herself and another one for his or her spouse, for a total of $8,100.

Concept Check 2-4

1. In addition to the dependent taxpayer test, joint return test, and citizen or resident test, a qualifying child must meet the following five tests: relationship test, age test, residency test, support test, and special test for qualifying child of more than one taxpayer.
2. The child must be under 19 years of age, or under 24 years of age and a full-time student. For years after 2008, the child must be younger than the person claiming the dependency.

Concept Check 2-5

1. False. A taxpayer must meet all of the four tests in order to be a qualifying relative.
2. False. A qualifying relative cannot earn an amount equal to or greater than the exemption amount, which is $4,050.

Concept Check 2-6

1. The amount of the standard deduction is
   a. Taxpayer is single, 42 years of age, and blind = 7,900 ($6,350 + $1,550).
   b. Taxpayer is head of household, 37 years of age, and not blind = $9,350.
   c. Taxpayers are married filing jointly, the husband is 67 and the wife is 61 years of age, and neither is blind = $13,950 ($12,700 + $1,250).

Concept Check 2-7

1. Tax for the single taxpayer is $4,728 and for the married taxpayers is $9,226.
2. The limitation for FICA (social security) for the year 2017 is $127,200.

Concept Check 2-8

1. The failure to file a tax return penalty does not apply because the taxpayer filed an extension before his or her return was due. However, the failure to pay does apply. The amount is $30 ([$3,000 × 0.5%] 2 months).
2. True. The IRS can assess criminal penalties in addition to civil penalties. The former are applicable to tax evasion, willful failure to collect or pay tax, and willful failure to file a return.

CHAPTER 3

Concept Check 3-1

1. In general, an individual must recognize income on his or her tax return if a transaction meets all of the following three conditions: There must be an economic benefit; there must actually be a transaction that has reached a conclusion; and the income must not be tax-exempt income.
2. True. Certain income is statutorily excluded from taxation and will not be included in gross income even though the other two conditions are met. An example is tax-exempt interest.

Concept Check 3-2

1. True. According to Reg. § 1.61-1(a), income may be realized in any form, whether in money, property, or services.
2. True. Receipt of property or services serves to trigger income recognition. Furthermore, taxpayers recognize income even if they receive it indirectly.

Concept Check 3-3

1. False. Interest is taxable if received from state or local bonds issued for private activities, such as convention centers, industrial parks, or stadiums.
2. False. Schedule B is required if an individual receives *over* $1,500 of interest for the tax year.

Concept Check 3-4

1. True. Qualified dividends (1) are made from the earnings and profits of the payer corporation and (2) are from domestic corporations or qualified foreign corporations.
2. False. Corporations normally pay dividends in the form of cash, but they may pay them in property or anything of economic value. The basis of the property received as a dividend in the hands of the shareholder is the property's fair market value at the date of distribution.

Concept Check 3-5

1. The amount is $27,750 (22,000 + 4,500 + 1,250).

Concept Check 3-6

1. Items such as jury duty and gambling winnings are listed under line 21 of the Form 1040.

Concept Check 3-7

1. False. It is not taxable. This is an example of a *de minimis* benefit whose value is so small that keeping track of which employees received the benefit is administratively impractical.
2. True. It is not taxable. The individual must be a degree-seeking student at an educational institution and must use the proceeds for qualified tuition and related expenses (tuition, fees, books, supplies, and equipment). If the scholarship or fellowship payment exceeds permitted expenses, the excess is taxable income.

Concept Check 3-8

1. True. The law limits the ability of taxpayers to create debt instruments with interest rates that materially vary from market rates on the date the instrument is created. Imputing interest will reallocate payments such that more of the payment will be interest and less principal.
2. True. If someone purchases a debt instrument (such as a bond) from an issuer for an amount less than par, the transaction creates original issue discount (OID). The initial OID is equal to the difference between the acquisition price and the maturity value.

CHAPTER 4

Concept Check 4-1

1. At least half-time at an eligible educational institution.
2. Tuition and fees.
3. $135,000.

Concept Check 4-2

1. Self-employed.
2. Nontaxable.
3. Form 8889 and Form 1040.

Concept Check 4-3

1. False. Under current IRS regulations, moving expenses can be deducted only as a *for AGI,* or *above-the-line,* deduction.
2. False. In order to deduct moving expenses, taxpayers must meet both tests in addition to the employment test.
3. True. To the extent that the employer reimburses the employee for moving costs, those costs cannot be deducted. However, if the total moving expenses exceed the reimbursement, those expenses in excess of the reimbursement can be deducted.

Concept Check 4-4

1. Net earnings.
2. For 2017, the employee's portion is calculated at 7.65%.
3. $200,000.

Concept Check 4-5

1. False. For self-employed individuals, the deduction is 100% of the costs.
2. False. The limitation on this deduction is that taxpayers cannot deduct the cost of premiums that exceeds *net* earnings from self-employment.
3. True. If the taxpayer is entitled to participate in any subsidized health plan maintained by any employer of the taxpayer or of the taxpayer's spouse, a deduction is not allowed.

Concept Check 4-6

1. As an *above-the-line* deduction.
2. Form 1099-INT.

Concept Check 4-7

1. False. Alimony payments can be made only in cash. If the payment consists of property, it is a property settlement.
2. False. As long as the couple is legally separated and there is a written agreement requiring payments, it will be classified as alimony.
3. True. If alimony payments decrease sharply in the second or third year of payment, this is a signal that the nature of the payments might be a property settlement, not alimony.

Concept Check 4-8

1. 900 hours.
2. $500.
3. Home schooling and non-athletic supplies for health or PE classes.

CHAPTER 5

Concept Check 5-1

1. 7.5% of AGI.
2. Actually paid. Payment by credit card meets this standard.
3. Insurance reimbursement.
4. Age.

Concept Check 5-2

1. True. In addition, the two other criteria are that it must be on personal property and the property must be assessed, at a minimum, on an annual basis.
2. False. When property is sold during the year, both the buyer and the seller receive a deduction for a portion of the real estate tax paid according to the number of days each owner held the property.
3. False. The tax benefit rule states that if you receive a refund of that expense that was previously deducted on the tax return, you are required to include that refund in income when it is received.
4. True. But generally most taxpayers receive a greater benefit by taking the credit.

Concept Check 5-3

1. Acquire, construct, or substantially improve.
2. $1,000,000.
3. Net investment.
4. 1%.

Concept Check 5-4

1. False. Charitable contributions can be taken only as an itemized deduction.
2. False. The overall limitation on the deductibility of charitable contributions is 50% of AGI. The 30% limit relates to the contribution of appreciated capital gain property.
3. True. If noncash gifts are worth over $500, the taxpayer must file Form 8283.

Concept Check 5-5

1. Sudden, unexpected, or unusual nature.
2. Form 4684 and then carried to Form 1040.
3. Two; $100.
4. 10%.

Concept Check 5-6

1. False. The threshold is 2% of AGI.
2. True. The amount calculated there goes to line 21 of the Schedule A.
3. False. The law does allow a deduction for uniforms required for employment as long as they would not usually be worn away from work. The accountant's blue suit would not fall into this category. However, a police officer's uniform would qualify for the deduction.

Concept Check 5-7

1. Limit.
2. 3%; 80%.

CHAPTER 6

Concept Check 6-1

1. False. Schedule C is used only for an activity in which the individual is self-employed, not an employee.
2. False. Any income received by the self-employed taxpayer is taxable and should be included on Schedule C. Not all individuals or organizations are required to send a 1099-MISC to the self-employed individual.
3. True. If inventory is a material item, it must be accounted for using the accrual method of accounting. The cash method can be used for all other items.

Concept Check 6-2

1. Ordinary, necessary, and reasonable.
2. Illegal bribes, kickbacks, and other such payments; payments for certain lobbying and political expenses; payments for fines and penalties.

Concept Check 6-3

1. \$1,300. When an asset is transferred from personal use to business use, the depreciable basis is the lesser of cost or FMV at transfer.
2. \$17,600. The adjusted basis at the end of year 1 is the cost less the accumulated depreciation (\$22,000 – \$4,400).

Concept Check 6-4

1. B. Autos are 5-year property under the MACRS rules.
2. C. An apartment complex is considered residential real property and thus has a 27.5-year life under the MACRS rules.
3. D. A warehouse is considered nonresidential real property and thus has a 39-year life under the MACRS rules.

Concept Check 6-5

1. False. A taxpayer must use the half-year convention for personal property unless more than 40% of the basis is purchased in the last quarter of the year; then mid-quarter is required. The taxpayer must use the mid-month convention for real property.
2. True. If more than 40% of the basis of personal property is purchased in the fourth quarter, the taxpayer must use the mid-quarter convention.
3. True. The only time the half-year convention is not used is when more than 40% of the personal property is purchased in the fourth quarter.
4. False. Because an apartment complex is residential real property, the mid-month convention is required.
5. True. Once the convention is established, it never changes for an asset. Thus if one half-year of depreciation is taken in the year of purchase, then one half-year of depreciation should be taken in the year of disposal. The same is true for mid-quarter and mid-month assets.

Concept Check 6-6

1. \$1,715. Equipment is a 7-year asset (\$12,000 × 14.29%).
2. \$1,049. 2018 would be the third year of depreciation, and the table percentage is 17.49% for year 3. But only one-half of a year of depreciation would be allowed (\$12,000 × 17.49% × $^1/_2$).
3. \$9,501. An apartment complex is 27.5-year, mid-month property purchased in March. The appropriate percentage is the third column of Table 6A-6 (\$330,000 × 2.879).

Concept Check 6-7

1. \$12,000 in § 179 expense and \$0 additional MACRS depreciation.
2. \$510,000 in § 179 expense (up to the limit of \$510,000 for 2017) and \$3,573 in 7-year MACRS depreciation (\$25,000 remaining basis × 14.29%).

Concept Check 6-8

1. C. \$25,000 in § 179 expense and \$2,800 in MACRS depreciation ([\$39,000 – \$25,000] × 20%) is allowed. The total is \$27,800.
2. C. \$25,000 × 80% business use = \$20,000 in § 179 expense and \$2,224 in regular depreciation ([\$39,000 × 80%] – \$20,000 § 179) × 20% (5-year MACRS percentage). The total is \$22,240.

Concept Check 6-9

1. False. The standard mileage rate incorporates depreciation into the mileage rate. A taxpayer uses either the standard mileage rate or the actual costs of operations including depreciation.
2. False. Transportation costs are deductible for all business travel except for commuting.
3. True. Once overnight rest is required with business travel, the taxpayer can then deduct meals and lodging.
4. True. Subject to the 50% limitation, a taxpayer can use the standard per diems of \$51/day. The per diems are higher in high-cost areas.
5. True. Subject to the 50% limitation, a taxpayer can deduct entertainment costs for clients assuming they are ordinary, necessary, and reasonable.

Concept Check 6-10

1. D. The external painting is an indirect cost and is deductible based on the business use ratio (\$3,000 × 20%). The office painting is a direct expense and is 100% deductible.
2. B. The home office expenses are deductible only to the extent of Schedule C income. Clients do not have to be seen at the home office, and § 179 is never allowed on real property. The home office can be depreciated over 27.5 years as residential real estate.
3. C. A business casualty loss when a property is partially destroyed is calculated using the lesser of the decrease in FMV or the adjusted basis of the property.

Concept Check 6-11

1. True. Typically, if an activity has shown a profit for three of five consecutive years, the activity is not considered a hobby. The burden of proving the activity is a hobby shifts to the IRS.
2. True. The expenses from a hobby can be used only to offset income from the hobby. Thus no net loss can occur.
3. True. Expenses such as real estate taxes and mortgage interest must be the first expenses deducted from hobby income. Otherwise these expenses could be deducted elsewhere (Schedule A) once all of the hobby income was offset.
4. False. If the educational costs help qualify the taxpayer for a new trade or business, the educational costs are not deductible.

Concept Check 6-12

1. \$6,076. \$43,000 × 92.35% × 15.3%.
2. \$1,152. \$43,000 × 92.35% × 2.9%. Kia has already paid through her employer the maximum amount of wages subject to social security. Kia still must pay Medicare because there is no limit.
3. \$5,306. \$43,000 × 92.35% × 2.9% = \$1,152 for Medicare. Because Kia has not reached the social security limit, an additional \$4,924 of social security must be paid (\$127,200 – \$85,000 = \$42,200 limit left; \$43,000 SE × 92.35% × 12.4%).

CHAPTER 7

Concept Check 7-1

1. False. The gain or loss is the difference between the amount realized from the sale and the asset's adjusted basis.
2. False. Form 4797 is used to record the gain or loss from an asset used in a trade or business.
3. True.

Concept Check 7-2

1. False. Inventory sold by a company appears on the income statement as the cost of goods sold and then on Schedule C for a sole proprietorship.
2. C. Property used in a trade or business.
3. False. Assets considered short-term are held for less than one year and are considered to be ordinary income assets.
4. True.
5. True.

Concept Check 7-3

1. False. When an ordinary asset is sold, the gain or loss is termed an "ordinary gain or loss."
2. The distinction is important because of the preferential tax rate treatment on capital gains versus ordinary gains.
3. True.

Concept Check 7-4

1. B. The tax treatment of a capital asset varies only if there is a gain. Losses are included for the netting process.
2. True.
3. False. Inherited property is always long-term property regardless of how long the asset belonged to the decedent or beneficiary.
4. False. The surtax is charged when MAGI is over the threshold amounts.
5. Collectible gains 28%

Collectible gains	28%
§ 1202 gains	28%
Unrecaptured § 1250 gains	25%
Taxpayer's regular rate ≥ 25% and < 39.6%	15%
Taxpayer's regular rate < 25%	0%
Taxpayer's regular rate is > 35%	20%

Concept Check 7-5

1. False. Losses are ordinary and fully deductible.
2. True.
3. Depreciation recapture rules transform some or all of a § 1231 gain into an ordinary gain.
4. § 1245 property is personal trade or business property subject to depreciation. § 1250 property includes depreciable real property used in a trade or business that has never been considered § 1245 property.
5. Unrecaptured gain is taxed at a 25% rate for all straight-line depreciation taken on the property. Recaptured gain is taxed at ordinary rates to the extent the depreciation taken exceeds straight-line depreciation.

Concept Check 7-6

1. First in, first out—The first shares purchased are the first shares sold. This results in the largest gain when the value of the mutual fund units appreciates.

   Specific identification—The taxpayer specifies exactly which units are for sale from the fund.

   Average basis—The taxpayer takes the total cost basis and divides by the total number of units to get an average cost per unit (single category).

2. True.
3. False. The basis for property given as a gift depends on whether the FMV was higher or lower than the basis at the date of the gift.
4. False. The tax treatment of a gain on the sale of inherited property is always considered to be held long term regardless of the holding period of the deceased.

CHAPTER 8

Concept Check 8-1

1. True. Income and expenses associated with rental property are reported on Schedule E unless the taxpayer is a real estate professional and the rental activity is considered a trade or business.
2. False. All ordinary and necessary expenses related to a rental property are deductible in the current year, but capital improvements must be depreciated and deducted over the useful life of the asset category.
3. True. Rental property is depreciated over 27.5 years for residential and 39 years for nonresidential using the straight-line method.
4. False. The income and expenses associated with a rental property that is considered to be the taxpayer's trade or business are reported on Schedule C.
5. False. Expenses paid by the tenant or services provided in lieu of rent payments are components of rental income and must be reported at the fair market value.

Concept Check 8-2

1. B. Primarily personal; rented less than 15 days.
2. A. Primarily rental; rented 15 days or more or personal use was less than 10% of rental days (i.e., less than 18 days).
3. A. Primarily rental; rented 15 days or more and personal use was no more than 14 days. Only 9 days of the 16 days are considered personal days because Darren worked for 7 days repairing the property.
4. C. Personal/rental; rented 15 days or more and personal use was more than 14 days.

Concept Check 8-3

1. Personal/rental. The property was rented for 75 days and used for personal use for 30 days. Rental property used for personal use more than 14 days (or 10% of days rented) and rented for 15 days or more is categorized as personal/rental.
2.

$6,000 × 75/105 =	$4,286
1,000 × 75/105 =	714
1,400 × 75/105 =	1,000
800 × 75/105 =	571
2,000 × 75/105 =	1,429
Allocated expenses	$8,000

3.

$6,000 × 75/365 =	$1,233
1,000 × 75/365 =	205
1,400 × 75/105 =	1,000
800 × 75/105 =	571
2,000 × 75/105 =	1,429
Allocated expenses	$4,438

4.

Rental income	$15,000
Allocated expenses	8,000
Net income	$ 7,000

Concept Check 8-4

1. Schedule C. Royalty received as a result of a trade or business should be reported on Schedule C.
2. Schedule E. Royalty produced by an investment should be reported on Schedule E.
3. Schedule C. Readings based on books written are not royalties but payment for services performed and should be reported on Schedule C.
4. Schedule E. Royalties are payments received for the right to use intangible property. The payments are for the use of Jane's textbook.

Concept Check 8-5

1. True. Flow-through entities supply each owner with a K-1 indicating his or her share of income, expenses, or losses.
2. False. Ordinary income from an S corporation is not considered self-employment income.
3. True. Partners, shareholders, or owners of flow-through entities must report their K-1 information on their individual tax returns on a Form E.
4. True. A taxpayer is allowed up to $25,000 of rental losses against other nonpassive income subject to limitations and phaseouts.

CHAPTER 9

Concept Check 9-1

1. $600
   $4,500 is more than maximum allowed, so use $3,000 × 20% = $600.

2. $4,500
   $500 × 9 months = $4,500; although expenses of $6,000 do not exceed the maximum allowed, the amount used cannot be greater than $4,500 because Katie is a student.
3. $570
   $2,900 – $1,000 = $1,900 × 30% = $570

Concept Check 9-2

1. $150

Base amount	$7,500
Less social security	1,000
Less 1/2 of AGI over $10,000	5,500
Allowable base amount	1,000
Applicable %	× 15%
Credit	$ 150

Concept Check 9-3

1. $ 580
   $2,900 × 20% = $580
2. $1,113
   100% of first $2,000 and 25% of second $900 is the credit allowed of $2,225. However, the credit is phased out due to AGI.
   $2,225 × ($90,000 – $85,000/$10,000) = $1,113
3. $0
   Her AGI is greater than the maximum phaseout amount.
4. $740
   ($1,600 + $2,100) × 20% = $740

Concept Check 9-4

1. $2,240
   ($8,000/$63,000) × $17,640 = $2,240 (less than foreign tax paid of $2,500)

Concept Check 9-5

1. $1,900
   $1,000 per child × 2 = $2,000; however, limitations apply due to AGI.
   ($112,000 – $110,000)/$1000 = 2; therefore,
   $2,000 – (2 × $50) = $1,900

Concept Check 9-6

1. $150
   $1,500 × 10% = $150
2. $1,000
   $2,000 × 50% = $1,000 ($2,200 over the maximum allowed)

Concept Check 9-7

1. $ 0 in 2016.
   $13,570 in 2017.
   $10,500 + $3,950 = $14,450; however, the maximum allowed is $13,570.
2. $13,075
   $16,000 is more than the maximum of $13,570, so use $13,570. The credit must be phased out because of AGI as follows:
   $13,570 × ([$243,540 – $205,000]/$40,000) × $13,570 = $13,075

Concept Check 9-8

1. $3,400
2. $2,110
   $3,400 (maximum credit) – ([$32,000 – $23,930] × 15.98%) = $2,110

3a. $5,616

3b. $4,816 refund
   $5,616 credit – $800 tax liability = $4,816 refund; EIC is a refundable credit.

Concept Check 9-9

1. No. The premium tax credit is only available to taxpayers with household income between 100% and 400% of the federal poverty level for the taxpayer's family size.
2. .0966

CHAPTER 10

Concept Check 10-1

1. True.
2. True.

Concept Check 10-2

1. False. They are also levied on noncash compensation as well as cash compensation other than through wages and salary.
2. False. Form W-4 is completed by the employee so the employer knows how much to withhold in federal income tax from the employee's compensation.
3. $52 if you use the wage bracket table, $51.03 if you use the percentage method.
4. $7,886.40 (limit $127,300) in social security and $1,892.25 in Medicare taxes (no limit).
5. False. Only tips in excess of $20 per month are subject to tax withholding.

Concept Check 10-3

1. False. New employers start as monthly schedule depositors. If in any one day tax liability equals $100,000, they become semiweekly schedule depositors.
2. False. The lookback period runs from the quarters starting July 1 of the current year through June 30 of the next year.
3. True.
4. False. A penalty is assessed only on the amount of tax that was not deposited on time.
5. True.

Concept Check 10-4

1. True.
2. A.
3. Individuals who employ household workers and do not withhold any taxes during the year. The schedule is attached to the taxpayer's Form 1040.
4. They paid any one household employee wages of $2,000 or more in 2017, federal income taxes were withheld from employee wages, and household wages of at least $1,000 were paid to all household workers combined in any calendar quarter in 2016 or 2017.

Concept Check 10-5

1. True.
2. Copy A is sent to the Social Security Administration along with Form W-3, which is the transmittal form. They are due January 31, 2018.
3. An employer who must correct an employee's W-2 must file Forms W-2C and W-3C as soon as possible.
4. The penalties for incorrectly preparing W-2s range from $50 per return to $260 per return with a maximum depending on the size of the business. Also a penalty of $530 per return (with no maximum) for intentional disregard for filing requirements.

Concept Check 10-6

1. Method 1: Withhold at a flat rate of 25%. If taxes are withheld from regular wages, add the two amounts together, calculate the tax as if they are one payment, and subtract the amount of withholding already taken out of the employee's wages. Method 2: If taxes are not already withheld from regular wages, add the two amounts together, and calculate the tax as if they are one payment.
2. True.
3. Form W-9 is used for U.S. persons (including resident aliens) to document their taxpayer identification number (TIN). This form must be on file by the payer.
4. $50 for each failure unless the failure is due to reasonable cause, not to willful neglect. If the taxpayer makes false statements with no reasonable basis that result in backup withholding, a penalty of $500 is assessed. There can also be criminal penalties including fines and imprisonment.
5. False. There is no way of knowing whether the taxpayer will overpay and have a refund. The estimated payments contribute by having taxpayers pay additional taxes to limit the amount of possible underpayment.

CHAPTER 11

Concept Check 11-1

1. False. Tax is only delayed (deferred), not forgiven.
2. Distribution.
3. False. It is an example of an employer-sponsored plan.
4. Employer-sponsored plans include qualified pension and profit-sharing plans, 401(k) or 403(b) plans, Keogh plans, SEPs, and SIMPLE plans. Choose any two.
5. True.

Concept Check 11-2

1. Defined benefit, defined contribution.
2. False. Some plans require employee contributions and some do not.
3. $18,000.
4. True. In fact, they can be used only by self-employed individuals.
5. True.

Concept Check 11-3

1. Traditional IRA and Roth IRA.
2. $6,500.
3. False. As long as neither individual is an active participant in an employer plan, a deductible contribution is permitted regardless of the amount of AGI.
4. True.

Concept Check 11-4

1. True.
2. $2,000.
3. $95,000. The phaseout is complete when AGI reaches $110,000.

Concept Check 11-5

1. True.
2. True.
3. 210.
4. 310.
5. True.

Concept Check 11-6

1. True.
2. True.
3. True.
4. False. Coverdell distributions must be used for higher education expenses (subject to certain restrictions). If not, the distributions are taxable.

Concept Check 11-7

1. An annuity is a series of payments under a contract.
2. False.
3. True.

CHAPTER 12

Concept Check 12-1

1. True. A gain is never recognized with a nontaxable like-kind exchange unless the taxpayer receives boot. Then gain is recognized to the lesser of the realized gain or the FMV of the boot received.
2. True. Those are the three conditions necessary to execute a nontaxable like-kind exchange.
3. False. The taxpayer has 45 days to identify the replacement property and 180 days to actually receive the replacement property.
4. True. The basis in the replacement property is the adjusted basis of the property given up, plus the basis of boot given, plus gain recognized, less the FMV of boot received. This sum is typically the FMV of the property received less the postponed gain.

Concept Check 12-2

1. \$55,000. If the building is not replaced, the insurance proceeds are treated as sale proceeds and the gain is recognized in full.
2. Three years. The typical replacement period is two years. However, for real property held for use in a trade or business, the replacement period increases to three years.
3. \$10,000 gain recognized. The realized gain of \$55,000 is recognized to the lesser of the proceeds not used for replacement or the realized gain. In this case, the amount not used is the lesser of the two (\$10,000).
4. \$0 gain recognized. All of the proceeds were used to replace the property.
5. \$60,000 is the adjusted basis. The basis is calculated as the cost of the new asset less the deferred gain (\$115,000 – \$55,000 deferred gain).

Concept Check 12-3

1. A. The gross profit percentage is calculated by dividing the gross profit by the gross sales prices (\$10,000/\$30,000 = 33.3%).
2. B. The income recognized is \$1,667 (the amount received in year two of \$5,000 × 33.3% gross profit percentage).

Concept Check 12-4

1. True. The maximum gain exclusion is \$500,000 for married taxpayers who file a joint return.
2. False. If the move is caused by an employment change or for health reasons, a taxpayer is eligible for some reduced exclusion. The exclusion is calculated by taking a ratio of the number of days used as a personal residence and dividing it by 730 days.
3. False. Johnny would still be allowed to exclude his gain but only to the maximum exclusion of \$250,000.

Concept Check 12-5

1. \$0. Because Leslie sold the stock to her brother, the related-party rules disallow any loss deduction on the sale by Leslie.
2. A. Leslie could deduct \$2,000 in capital losses. In order for a corporation (or other entity) to be considered a related party, Leslie would have to have control of the corporation (greater than 50% ownership).
   B. \$0. Because Leslie now has control of the corporation, she is considered a related party and the loss would be disallowed.
3. The purpose of the wash sale rules is to disallow a tax loss where the ownership of a company is not reduced. Thus if a taxpayer buys similar stock within 30 days of a stock sale (before or after), any loss on the sale is disallowed.

CHAPTER 13

Concept Check 13-1

1. D. All of the above increase the at-risk of a taxpayer. See Table 13-1 for all of the increases and decreases of at-risk.

2. A. Nonrecourse debt does not increase the taxpayer's at-risk. Nonrecourse debt is debt that the taxpayer is not personally liable for.
3. C. The loss is indefinitely carried forward and can be deducted once the taxpayer gets additional at-risk.

Concept Check 13-2

1. True. The only way a rental property is not a passive activity is when the taxpayer is a real estate professional. A rental business can qualify for nonpassive treatment if more than one-half of the personal services performed in a business during the year is performed in a real property trade or business and the taxpayer performs more than 750 hours of services in the activity.
2. True. Passive losses are allowed only to the extent of passive income. One exception is the $25,000 offset for rental properties.
3. False. The $25,000 offset is limited to $25,000 and is phased out after a taxpayer's AGI reaches $100,000.
4. True. Any suspended passive losses are allowed when the activity is sold.

Concept Check 13-3

1. In order for a loss to be deducted, it must first be allowed under the at-risk rules. Once the loss is allowed under the at-risk rules, the passive loss rules are applied.
2. The main reason is that passive losses are allowed when an activity is sold or disposed of. Thus if a taxpayer were considering the sale of a passive activity, he or she could lump all suspended passive losses on one activity and sell it. All of the losses would then be allowed. The allocation to all loss activities stops this potential abuse.
3. The taxpayer is eligible for the $25,000 offset for rental losses. However, the $25,000 limit is phased out once the taxpayer's AGI reaches $100,000 ([$105,000 − $100,000] × $^1/_2$ = $2,500). Thus only $22,500 of the rental loss would be allowed.

Concept Check 13-4

1. True. The AGI floor for medical expenses is 10% for AMT purposes and regular tax for most taxpayers. Some taxpayers over 65 still get the 7.5% floor until after the 2017 tax year.
2. True. No taxes are allowed as a deduction for AMT. Any taxes deducted on the regular return are added back as a positive adjustment for AMT.
3. True. Personal exemptions are added as a positive adjustment for AMT purposes.
4. True. If AMTI is greater than $187,800, the AMT rate is 28%.

CHAPTER 14

Concept Check 14-1

1. True. The only time gain is recognized by a contributing partner is when the partner receives an interest for services or when he or she is released of a liability in excess of basis.
2. True. The basis of the assets typically carries over from the partner to the partnership.
3. False. The basis is dependent on the basis of the assets the individual partners contributed to the partnership. One partner could have a $0 basis while the other partner might have $100,000, yet both share 50% in the profit and loss of the partnership.
4. False. Gain must be recognized to the extent of the FMV of the partnership interest received for services.
5. True. An increase or decrease in partnership liabilities is treated as a cash contribution or cash distribution and thus increases or decreases partnership basis.

Concept Check 14-2

1. D. All of the above can be deducted from partnership income to determine the net income or loss from the partnership.
2. C. Any form of partnership files a Form 1065 informational return each year.
3. D. A guaranteed payment is a payment, usually for services, that is determined without regard to partnership income and is deductible by the partnership.

Concept Check 14-3

1. All income and expense items of a partnership that may be treated differently at the partner level must be "separately stated." Rental income/loss, capital gains/losses, and charitable contributions all can be treated differently at the partner level. For example, an individual partner can take up to $3,000 of capital losses against ordinary income while a corporate partner in the same partnership cannot.
2. A partner is not an employee of the partnership. Thus income received by the partner from the partnership has no social security or Medicare withheld by the partnership.

Concept Check 14-4

1. True. These are two of the uses of basis. Basis is also used to determine the basis (or whether a gain is recognized) of property distributed.

2. False. If the basis is not increased by tax-exempt income, then the exempt income will eventually be taxed when the partnership interest is sold. The lower basis will cause a higher gain upon sale.
3. False. The basis is first reduced by all adjustments except for losses, then money distributed, and then the basis of any property distributed. After those items, any basis remaining is used to determine the deductibility of losses.
4. False. The basis is always increased by the partner's share of recourse debt.

Concept Check 14-5

1. B. If a cash distribution or a release of liabilities exceeds basis, the partner will have a gain on a distribution from the partnership.
2. B. $12,000—the furniture would be reduced to the basis left in the partnership.
3. A. $8,000—the basis in the partnership is first reduced by the cash distribution. That leaves $8,000 for the furniture.

Concept Check 14-6

1. A. Shelly's recognized gain would be $0. She did not receive cash in excess of her basis.

   B. Shelly's basis in the assets would be as follows:

Cash	$9,000
Inventory	$6,000
Equipment ($15,000 × $8,000/$20,000)	$6,000
Land ($15,000 × $12,000/$20,000)	$9,000

2. A. $99,000 ($55,000 beginning basis + $18,000 + $26,000)

   B. $8,000 ($107,000 sales price – $99,000 *basis*)

   C. Because the partnership interest is a capital asset and there was no mention of inventory or receivables in the partnership, the gain would be a long-term capital gain.

CHAPTER 15

Concept Check 15-1

1. False. Some corporations are prohibited from using the cash basis. Corporations with average annual revenues over $5 million must use the accrual basis. Corporations with inventory must use the accrual basis at least for sales and cost of goods sold.
2. The 15th day of the fourth month after the fiscal year end.
3. False. In the first year of operation, a corporation establishes its tax year. Although many corporations choose December 31, that date is not required.

Concept Check 15-2

1. True. Although an exchange of cash or property can be taxable, if the 80% rule is met, the formation activities are generally tax-free.
2. The basis in the hands of the shareholder plus any gain recognized by the shareholder.
3. $40,000. His basis in the stock is his carryover basis in the land.

Concept Check 15-3

1. False. Corporations cannot report a net capital loss whereas individuals can take up to $3,000 in capital losses in any tax year.
2. $176,800. Tax liability is equal to $113,900 plus 34% of the amount of taxable income over $335,000.
3. $39,000. A corporation can take a charitable contribution in an amount not to exceed 10% of taxable income before charitable contribution.
4. False. Although organizational expenses are deductible over 180 months or more, the corporation must make an affirmative election in its first tax return in order to do so.
5. 2, 20.

Concept Check 15-4

1. True. By definition, a dividend is a distribution from the earnings and profits of a corporation. Dividends are taxable to the shareholder. If a distribution is in excess of the earnings and profits of the corporation, it is not a dividend. It may or may not be taxable depending on the stockholder's basis in his or her stock.
2. False. Property dividends are taxed on the fair value of the property received by the stockholder.
3. $10,000. The amount of the dividend cannot exceed the earnings and profits of the corporation.

Concept Check 15-5

1. False. Corporations with total receipts and total assets under $250,000 are not required to complete Schedule L.
2. True.
3. Negative. Schedule M-1 reconciles from book income to tax income. There is more depreciation on the tax return than on the books. That means book income needs to be reduced to arrive at taxable income.

Concept Check 15-6

1. 80%.
2. Five.
3. $40,000.

Concept Check 15-7

1. False. Not only must a corporation meet tests in addition to the 100 shareholder limit, the corporation must also affirmatively elect Subchapter S status.
2. True. While there are some differences, the tax treatments of a partnership and a Subchapter S corporation are similar.
3. 1120S.
4. Not taxable. Subchapter S dividends are not taxable to a shareholder.
5. False. Corporate debt does not affect shareholders' basis in their stock.