Federal Income Tax

Mid-term Exam

NAME: **Jacob Wall**

**1. Pat Good took in a homeless person, Bob. Pat provided Bob with food and a room, and in the evening Pat taught Bob to read. Bob lived with Pat throughout the entirety of 2013. During 2013, Bob began mowing a few lawns for extra money. He earned fees for services rendered of $5,000 and had expenses of $1,000 for gas and $400 for advertising. Can Pat claim Bob as a dependent?**

Yes! Pat can claim Bob because his income was $3,600 which is less than the $3,900 the IRS requires.

**2. John and Jane, who are not married, have a child together. They all live together in one home and have for all of 2013. John earns $18,000 per year as a waiter and Jane earns $55,000 as an accountant. What filing status should each person use on their return and how many exemptions should each claim?**

Jane should file as head of household taking a deduction for John and the child for a total of three exemptions. John should claim as single and with zero exemptions.

**3. Mary and Johanne were divorced on December 24, 2013. They have no children. What filing status must each use on their return(s)?**

The IRS considers Mary and Johanne as if they were never married as you have to be married thru December 31 in order for you to file as married and filing jointly. They can file as single or, if they qualify, as head of household.

**4. Stacy has a 2 year old daughter, Jeanie. Stacy is 23 years old, lives at home with her mother, Claire, and is a full time student at the local university. Stacy does not work and earns no money. Who must file a tax return and how many exemptions should each filer claim?**

Claire can file as married, if applicable, single, or head of household – whichever applies best in her situation. Claire can also take the deduction for her child, Stacy, and her grandchild Jeanie.

**5. Mary’s husband, Earl, died in 2012. They had no children. What filing status should Mary use on her tax return for 2013?**

Single.

6. Richard and Ann have been married 45 years. During 2013, Richard receives $14,000 per year in social security income. Ann still works and earns $38,000 as a teacher in a private preschool. On their joint return for 2013, assuming no other sources of income, what is their adjusted gross income.

$44,850

**7. BD Debtor, Inc borrowed $1 million from Angel Bank to acquire a building. During 2013, Angel Bank forgave $300,000 of the note. At that time, the building was worth $700,000 and BD Debtor had cash on hand of $50,000. How much COD income must BD Debtor recognize in 2013?**

Assuming that they are not insolvent then they would have COD income of $300,000. If they are insolvent then BD Debtor, Inc. would have COD income in the amount of the assets exceeding liabilities, with a cap of $300,000.

**8. John and Terry are married and had gross income of $190,000 from salaries during 2013. They use the standard deduction. What is their federal tax liability for 2013?**

Using the following:

Tax Bracket: $146,401 - $223,050

Tax Obligation: $28,457.50 + 28% of the excess over $146,400

|  |  |
| --- | --- |
| **Gross Income:** | $190,000 |
| **Standard Deduction:** | ($8,950) |
|  | $181,050 |
| **Less:** | ($146,400) |
|  | $34,650 |
| **Tax Rate** | 28% |
|  | $9,702 |
| **Plus: Tax Assumption (See Notes)** | $28,457.50 |
|  | $38,159.50 |

**9. John purchased a truck for $30,000 to use in his lawn maintenance business on February 1, 2013. It was his only equipment acquisition for the year. How much depreciation expense is John entitled to deduct for 2013? Ignore any bonus or additional depreciation that might be available.**

John’s purchase will be using the mid year convention for depreciation. Using the assumption of a 7/1/2013 purchase he could then deduct $15,000.

**10. Cynthia acquired a copy machine to use in her floral business on March 1, 2013 at a cost of $5,000. She also acquired a delivery vehicle for $8,000 on November 1, 2013. What is Cynthia’s total depreciation expense for 2013? Ignore any bonus or additional depreciation that might be available.**

Since Cynthia had more than 40% of her purchases in the 4th quarter she will need to use the mid quarter convention for depreciation.

|  |  |
| --- | --- |
| **Copy Machine:** | $5,000 |
| **Amount to Depreciate:** | 7/8 |
|  | $4,375 |
|  |  |
| **Delivery Vehicle:** | $8,000 |
| **Amount to Depreciate:** | 1/8 |
|  | $1,000 |
|  |  |
| **Sum of Depreciation:** | $5,375.00 |

11. Barbara sold a piece of manufacturing equipment during 2013 for $12,000. She originally purchased the equipment for $70,000 and has taken aggregate depreciation deductions of $56,000. What is Barbara’s gain or loss on the sale of the equipment?

|  |  |
| --- | --- |
| **Purchase Price:** | $70,000 |
| **Depreciated Amount:** | ($56,000) |
| **Adjusted Basis:** | $14,000 |
|  |  |
| **Selling Price:** | $12,000 |
| **Less: Adjusted Basis** | ($14,000) |
| **Gain / (Loss)** | ($2,000) |

**12. During 2013, Ronny sold stock in ABC, Inc for $3,500 that he purchased 4 years ago for $10,000. He also sold a Dallas muni bond for $1,050 that he purchased for $1,000 18 months ago. He also earned $1,000,000 in salary. How much of Ronny’s capital loss may he deduct during 2013?**

Ronny may deduct the maximum allowance for a capital loss of $3,000.

**13. Roy purchased a bond for $700 that matures with a par value of $1,000 in 10 years. The bond pays a coupon of 9%.**

**(a) how much OID should Roy recognize in year 1?**

1) ($1,000 - $700) = $300 \* (1/10) = $30

**(b) Assume Roy sold the bond at the end of year 1 for $750. What is his gain or loss on the sale of the bond?**

OID Income of $30, Capital Gain income of $20.

14. Jack has an AGI of $50,000. He itemizes his deductions. During 2013 he paid his stock broker $1,200 in management fees. How much of that amount may Jack deduct?

|  |  |
| --- | --- |
| **AGI:** | $50,000 |
| **2% Floor** | 2% |
| **Floor** | $1,000 |
|  |  |
| **Management Fees:** | $1,200 |
| **Less: Floor** | ($1,000) |
|  | $200.00 |

**15. Francis owns a condo in Maui. She rents out the condo 300 days per year for total rental income of $45,000. She uses the condo for her own personal purposes for 20 days per year. During the year, she incurred $30,000 in interest expense for the mortgage, $10,000 per year for property taxes and $12,000 in depreciation expense. How much may Francis deduct on schedule A as itemized deductions? How much may Francis deduct as an above the line deduction (i.e. the net loss from rental activities actually shown on page 1 of form 1040)?**

You would be able to claim a $7,000 Loss ($52,000 Expense - $45,000 Income) on your schedule A as an itemized deduction for the interest, property taxes, and depreciation.

You would still deduct, as an above the line deduction, a net loss of $7,000 on form 1040.

**16. Brody’s truck was stolen and was not insured. The value of the truck was $8,000. In addition, a storm knocked down his pool house, which had a value of $60,000. His insurance company only reimbursed him for $45,000. Brody’s AGI is $100,000. How much casualty/theft loss may Brody deduct?**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Truck** |  |  | **Pool House** |
| **Value:** | $8,000 |  | **Value** | $60,000 |
| **Less Deductible:** | ($100) |  | **Less Deductible:** | ($100) |
|  | $7,900 |  | **Less Insurance Payout:** | ($45,000) |
|  |  |  |  | $14,900 |
|  |  |  |  |  |
| **Truck + Pool House** | $22,800 |  |  |  |
| **Less: 10% AGI** | ($10,000) |  |  |  |
|  | **$12,800.00** |  |  |  |

**17. Alex owns two corporations. ABC corp is a C corporation for federal tax purposes and XYZ corp is an S corporation. He formed both companies on January 1, 2013 by contributing $5,000. Each corporation earned $4,000 during 2013. Each corporation distributed $3,500 during 2013. How much taxable income should Alex recognize from each during 2013? What is his basis in the stock of each corporation at the end of 2013?**

C Corp: $2,400 as Return on Capital and $1,100 as Capital Gains

S Corp: $3,500 as Return on Capital

|  |  |  |
| --- | --- | --- |
|  | **C Corp** | **S Corp** |
| **Historical Basis** | $5,000 | $5,000 |
| **Income** | $4,000 | $4,000 |
| **Taxes** | ($1,400) | $0 |
| **(Cash Received)** | ($3,500) | ($3,500) |
| **(Losses)** | $0 | $0 |
| **Additional Investments** | $0 | $0 |
| **Adjusted Basis** | $4,100 | $5,500 |

**18. Ashley’s employer withheld $2,000 from her paycheck during 2012 for Oklahoma income taxes. In 2013 she filed her Oklahoma tax return and only owed $1,700. The state of Oklahoma sent her a $300 refund, which she received in 2013. Ashley did not itemize her deductions during 2012. How much income should she recognize during 2013 as a result of the refund?**

She shouldn’t recognize the refund as income as it was a tax-free loan to the government.

**19. Jeff owns an interest in two LLC’s, X LLC and Y LLC. Each entity is engaged in a trade or business. X LLC is a bookkeeping service, which has one part time contract employee. During the year, Jeff worked 425 hours in X LLC’s trade or business and his contract employee worked 325 hours. Jeff also worked 425 hours in Y LLC’s trade or business, which has multiple full time employees throughout the year. X LLC allocates $1,500 in operating losses to Jeff during the year and Y LLC allocates $3,000 in operating losses to Jeff during the year. Under the passive loss rules, how much of Jeff’s allocated losses may he deduct?**

Jeff can deduct $1,500 in operating losses for X LLC. He wouldn’t be able to deduct anything for Y LLC.

**20. Same question as #19 except that Jeff’s employee in X LLC works 600 hours during the year. Under the passive loss rules, how much of Jeff’s allocated losses may he deduct?**

He wouldn’t be able to deduct anything.

**21. Same question as # 19 except that Jeff works 150 hours in each business. Further, X LLC has net income for the year of $2,500 instead of a loss. Under the passive loss rules, how much of Jeff’s allocated loss may he deduct?**

He wouldn’t be able to deduct any losses for Y LLC as he still does not meet being a material participant. With X since there is a gain, he would have to claim that gain.