

59. **LO.5, 7, 10** B. J. and Carolyn Grace are full-time employees. B. J. is an elementary school teacher, and Carolyn is a registered nurse at a hospital. During the year, they incur the following employment-related expenses:

School supplies for use in the classroom	\$1,400
Emergency room uniforms	800
Union dues (teachers association)	200
Job hunting expenses (Carolyn obtained another nursing position but decided not to change jobs)	1,300
Continuing education correspondence courses (required to maintain nursing license)	380
Professional dues and subscriptions	1,100

None of these expenses are reimbursed by the employers.

For the year, the Graces file a joint return reflecting salary income of \$90,000. They also have gambling income of \$6,000 and gambling losses of \$7,000 (fully substantiated). They pay \$400 to have their tax return prepared. They have other itemized deductions (i.e., interest on home mortgage, property taxes on personal residence, state income taxes, and charitable contributions) of \$14,500. Determine the total amount of itemized deductions allowed to the Graces.

60. **LO.1, 2, 4, 5, 7, 10** Complete the following table by classifying each of the independent expenditures (assume that no reimbursement takes place).

Expense Item	Deductible for AGI	Deductible from AGI	Not Deductible
a. Moving expense of an employee	_____	_____	_____
b. Tax return preparation fee incurred by an employed plumber	_____	_____	_____
c. Safety glasses purchased by an employed pipefitter	_____	_____	_____
d. Dues to auto club (e.g., AAA) for taxpayer who uses the automatic mileage method	_____	_____	_____
e. Nursing refresher course for taxpayer who retired from nursing five years ago	_____	_____	_____
f. Gambling loss <i>not</i> in excess of gambling gain by a self-employed architect	_____	_____	_____
g. Contribution to Roth IRA by a self-employed attorney	_____	_____	_____
h. Business travel expenses by a statutory employee	_____	_____	_____
i. Job hunting expense by an elementary school teacher seeking a position as an elementary school principal	_____	_____	_____
j. Cost of bar exam review course taken by a recent law school graduate	_____	_____	_____

Cumulative Problems

Tax Return Problem

Tax Software

Sch C
☒ *Stat. Employee*
Box

61. David R. and Ella M. Cole (ages 39 and 38, respectively) are husband and wife who live at 1820 Elk Avenue, Denver, CO 80202. David is a regional sales manager for Wren Industries, a national wholesaler of plumbing and heating supplies, and Ella is a part-time dental hygienist for a chain of dental clinics.

• David is classified by Wren as a statutory employee with compensation for 2013 (based on commissions) of \$95,000. He is expected to maintain his own office and pay for all business expenses from this amount. Wren does not require him to render any accounting as to the use of these funds. It does not withhold Federal and state income taxes but does withhold and account for the payroll taxes incurred (e.g., Social Security and Medicare). David is covered by Wren's noncontributory medical plan but has chosen not to participate in its § 401(k) retirement plan.

David's employment-related expenses for 2013 are summarized below:

Airfare	\$8,800
Lodging	5,000
Meals (during travel status)	4,800
Entertainment	3,600
Ground transportation (e.g., limos, rental cars, and taxis)	800
Business gifts	900
Office supplies (includes postage, overnight delivery, and copying)	1,500

The entertainment involved business meals for purchasing agents, store owners, and building contractors. The business gifts consisted of \$50 gift certificates to a national restaurant. These were sent by David during the Christmas holidays to 18 of his major customers.

In addition, David drove his 2011 Ford Expedition 11,000 miles for business and 3,000 for personal use during 2013. He purchased the Expedition on August 15, 2010, and has always used the automatic (standard) mileage method for tax purposes. Parking and tolls relating to business use total \$340 in 2013.

When the Coles purchased their present residence in April 2010, they devoted 450 of the 3,000 square feet of living space to an office for David. The property cost \$440,000 (of which is attributable to the land) and has since appreciated in value. Expenses relating to the residence in 2013 (except for mortgage interest and property taxes; see below) are as follows:

Insurance	\$2,600
Repairs and maintenance	900
Utilities	4,700
Painting office area; area rugs and plants (in the office)	1,800

In terms of depreciation, the Coles use the MACRS percentage tables applicable to 39-year nonresidential real property. As to depreciable property (e.g., office furniture), David tries to avoid capitalization and uses whatever method provides the fastest write-off for tax purposes.

- Ella works part-time as a substitute for whichever hygienist is ill or on vacation or when one of the clinics is particularly busy (e.g., prior to the beginning of the school year). Besides her transportation, she must provide and maintain her own uniforms. Her expenses for 2013 appear below.

Uniforms	\$690
State and city occupational licenses	380
Professional journals and membership dues in the American Dental Hygiene Association	340
Correspondence study course (taken online) dealing with teeth whitening procedures	420

Ella's salary for the year is \$42,000, and her Form W-2 for the year shows income tax withholdings of \$4,000 (Federal) and \$1,000 (state) and the proper amount of Social Security and Medicare taxes. Because Ella is a part-time employee, she is not included in her employer's medical or retirement plans.

- Besides the items already mentioned, the Coles had the following receipts during 2013.

Interest income—	
State of Colorado general purpose bonds	\$2,500
IBM bonds	800
Wells Fargo Bank CD	1,200
Federal income tax refund for year 2012	
Life insurance proceeds paid by Eagle Assurance Corporation	
Inheritance of savings account from Sarah Cole	
Sales <u>proceeds</u> from two ATVs	

tax exempt

510 NT
200,000 NT

50,000 NT

Sold @ loss which is nondeduct

subject to 50% reduction

ltd to \$25 each x 18

450/3000 = 15%

X 15%
in full \$179

start 2/06 → Sch A misc 2%

Sarah
dependent
for 2013

For several years, the Coles's household has included David's divorced mother, Sarah, who has been claimed as their dependent. In late November 2013, Sarah unexpectedly died of coronary arrest in her sleep. Unknown to Ella and David, Sarah had a life insurance policy and a savings account (with David as the designated beneficiary of each). In 2012, the Coles purchased two ATVs for \$14,000. After several near mishaps, they decided that the sport was too dangerous. In 2013, they sold the ATVs to their neighbor.

- Additional expenditures for 2013 include:

Funeral expenses for Sarah		\$ 4,500	
Taxes—			
Real property taxes on personal residence	\$6,400	15% Sch C	85% Sch A
Colorado state income tax due (paid in April 2013 for tax year 2012)	310	6,710	
Mortgage interest on personal residence		6,600	15% Sch C 85% Sch A
Paid church pledge		2,400	Sch A
Contributions to traditional IRAs for Ella and David (\$5,500 + \$5,500)		11,000	pg 1 of 1040 adj

In 2013, the Coles made quarterly estimated tax payments of \$1,400 (Federal) and \$500 (state) for a total of \$5,600 (Federal) and \$2,000 (state). put all in 1st 3 estimated pymts

Part 1—Tax Computation

Using the appropriate forms and schedules, compute the Coles's Federal income tax for 2013. Disregard the alternative minimum tax (AMT) and various education credits as these items are not discussed until later in the text (Chapters 12 and 15). Relevant Social Security numbers are:

David Cole	123-45-6788
Ella Cole	123-45-6787
Sarah Cole	123-45-6799

The Coles do not want to contribute to the Presidential Election Campaign Fund. Also, they want any overpayment of tax refunded to them and not applied toward next year's tax liability. Suggested software: H&R BLOCK Tax Software Pro Series

Part 2—Follow-Up Advice

Ella has always wanted to pursue a career in nursing. To this end, she has earned a substantial number of college credits on a part-time basis. With Sarah no longer requiring home care, Ella believes that she can now complete her degree by attending college on a full-time basis.

David would like to know how Ella's plans will affect their income tax position. Specifically, he wants to know:

- How much Federal income tax they will save if Ella quits her job.
- Any tax benefits that might be available from the cost of the education.

Write a letter to David addressing these concerns. Note: In making your projections, assume that David's salary and expenses remain the same. Also disregard any consideration of the various educational tax credits as these are not discussed until Chapter 12.

Tax Computation Problem

62. Addison Parker, single and age 32, lives at 3218 Columbia Drive, Spokane, WA 99210. She is employed as regional sales manager by VITA Corporation, a manufacturer and distributor of vitamins and food supplements. Addison is paid an annual salary of \$83,000 and a separate travel allowance of \$24,000. As to the travel allowance, VITA does not require any accounting on the part of Addison. non deductible plan = income

- Addison participates in VITA's contributory health and § 401(k) plans. During 2014, she paid \$3,500 for the medical insurance and contributed \$11,000 to the § 401(k) retirement plan. Sch A
- Addison uses her automobile 70% for business and 30% for personal. The automobile, a Toyota Avalon, was purchased new on June 30, 2012, for \$37,000 (no trade-in was involved). Depreciation has been claimed under MACRS 200% declining balance method, and no § 179 election was made in the year of purchase. (For depreciation information, see the IRS Instructions for Form 4562, Part V). During 2014, Addison

Forms:

1040 8829

2106

Schedules:
A, B, C

2014
manual

83
+ 24
107 Wages
line 7

no state
income
tax

non deductible plan = income

pg 1 deductions for AGI

drove 15,000 miles and incurred and paid the following expenses relating to the automobile:

Gasoline	\$3,100
Insurance	2,900
Auto club dues	240
Interest on car loan	1,100
Repairs and maintenance	1,200
Parking (during business use)	600
Traffic fines (during business use)	500

Form 2106 feeds to Sch A
misc 2% floor 5

- Because VITA does not have an office in Spokane, the company expects Addison to maintain one in her home. Out of 1,500 square feet of living space in her apartment, Addison has set aside 300 square feet as an office. Expenses for 2014 relating to the office are listed below.

Rent	\$18,000
Utilities	4,000
Insurance (renter's casualty and theft coverage)	1,600
Carpet replacement (office area only)	1,200

$$\frac{300}{1500} = 20\%$$

Form 8829
office in the home
feeds to 2106

- Addison's employment-related expenses (except for the trip to Korea) for 2014 are summarized below.

Airfare	\$4,100
Lodging	3,200
Meals	2,800
Entertainment (business lunches)	2,400
Transportation (taxis and airport limos)	300
Business gifts	540
Continuing education	400
Professional journals	140

Form 2106
feeds to Sch A

Most of Addison's business trips involve visits to retail outlets in her region. Store managers and their key employees, as well as some suppliers, were the parties entertained. The business gifts were boxes of candy costing \$30 (\$25 each plus \$5 for wrapping and shipping) sent to 18 store managers at Christmas. The continuing education was a noncredit course dealing with improving management skills that Addison took online.

- In July 2014, Addison traveled to Korea to investigate a new process that is being developed to convert fish parts to a solid consumable tablet form. She spent one week checking out the process and then took a one-week vacation tour of the country. The round-trip airfare was \$3,600, while her expenses (relating to business) were \$2,100 for lodging (\$300 each night), \$1,470 for meals, and \$350 for transportation. Upon returning to the United States, Addison sent her findings about the process to her employer. VITA was so pleased with her report that it gave her an employee achievement award of \$10,000. The award was sent to Addison in January 2015.
- Addison provides more than 50% of the support of her parents (Gordon and Anita Parker), who live in Seattle. In addition to modest Social Security benefits, her parents receive a small amount of interest on municipal bonds and nontaxable retirement income.
- Besides the items already mentioned, Addison had the following receipts in 2014:

$$18 \times \$30$$

airfare has to be prorated
 $\frac{1}{2}$ BS

so not on 2014 return
consider them her dependents

Interest income—

City of Tacoma general purpose bonds	\$ 350	
Olympia State Bank	400	\$ 750

Proceeds from property sales—

City lot	\$13,000	
Sailboat	18,000	31,000
Cash found at airport		5,000

taxable "other" line 21

Regarding the city lot (located in Vancouver), Addison purchased the property in 2000 for \$16,000 and held it as an investment. Unfortunately, the neighborhood where the lot was located deteriorated, and property values declined. In 2014,

since investment is
deductible loss
Sch D

*Gain on boat
taxable - Sch D*

Addison decided to cut her losses and sold the property for \$13,000. The sailboat was used for pleasure and was purchased in 2010 for \$16,500. Addison sold the boat because she purchased a new and larger model (see below). While at the Spokane airport, Addison found an unmarked envelope containing \$5,000 in \$50 bills. As no mention of any lost funds was noted in the media, Addison kept the money. *Taxable line 21 Other*

- Addison's expenditures for 2014 (not previously noted) are summarized below.

<i>Sch A</i>	Medical (not covered by insurance)	\$7,000	
	State and local general sales tax	3,300	
	Church pledge (2013 and 2014) <i>all in 2014</i>	5,600	<i>Sch A misc 2%</i>
	Fee paid for preparation of 2013 income tax return	500	
	Contribution to mayor's reelection campaign fund	200	
	Premiums on life insurance policy	2,100	
	Contribution to a Coverdell Education Savings account (on behalf of a favorite nephew)	2,000	<i>Not deductible</i>

Most of the medical expenses Addison paid were for her mother's dental implants. Addison keeps careful records regarding sales taxes. In 2014, the sales tax total was unusually high due to the purchase of a new sailboat. In 2014, Addison decided to pay her church pledge for both 2013 and 2014. The insurance premium was on a policy covering her father's life. (Addison is the designated beneficiary under the policy.)

Relevant Social Security numbers are 123-45-6785 (Addison), 123-45-6783 (Gordon), and 123-45-6784 (Anita). Addison's employer withheld \$5,600 for Federal income tax purposes, and she applied her \$800 overpayment for 2013 toward the 2014 tax liability.

Compute Addison's Federal income tax payable (or refund) for 2014. In making the calculation, use the Tax Rate Schedule and disregard the application of the alternative minimum tax (AMT), which is not discussed until Chapter 15.

*Do manual
return for
2014*

Forms 1040, 8849, 2106, 4562 ~~Sch A, D~~ 8829

Research Problems

THOMSON REUTERS

CHECKPOINT®

Note: Solutions to Research Problems can be prepared by using the **Checkpoint® Student Edition** online research product, which is available to accompany this text. It is also possible to prepare solutions to the Research Problems by using tax research materials found in a standard tax library.

Research Problem 1. Aaron, a resident of Minnesota, has been a driver for Green Delivery Service for the past six years. For this purpose, he leases a truck from Green, and his compensation is based on a percentage of the income resulting from his pickup and delivery services. Green allows its drivers to choose their 10-hour shifts and does not exercise any control on how these services are carried out (e.g., the route to be taken or the order in which parcels are delivered or picked up). Under Green's operating agreement with its drivers, Green can terminate the arrangement after 30 days' notice. In practice, however, Green allows its truckers to quit immediately without giving advance notice. The agreement also labels the drivers as independent contractors. Green maintains no health or retirement plans for its drivers, and each year it reports their income by issuing Forms 1099-MISC (and not Forms W-2). Green requires its drivers to maintain a commercial driver's license and be in good standing with the state highway law enforcement division.

Citing the employment tax Regulations in §§ 31.3121(d)-1(c)(2) and 31.3306(i)-1(b), an IRS agent contends that Aaron is an independent contractor and, therefore, is subject to the self-employment tax. Based on *Peno Trucking, Inc.* (93 TCM 1027, T.C.Memo. 2007-66), Aaron disagrees and contends that he is an employee (i.e., not self-employed). Who is correct? Why?

Research Problem 2. Your client, a large construction firm organized as a C corporation, allows certain employees (including the president of the corporation) to use its company-owned airplane for nonbusiness flights. The employees include the value of those flights in their income. Your client is uncertain about how to treat the expenses related to these nonbusiness flights. In certain situations the expenses of operating the plane are more than the income imputed to the employees and in certain circumstances the expenses are less. In doing some of their own research, your client found *Sutherland Lumber-*