Test Bank for Concepts in Federal Taxation 2022 29th Edition by Murphy

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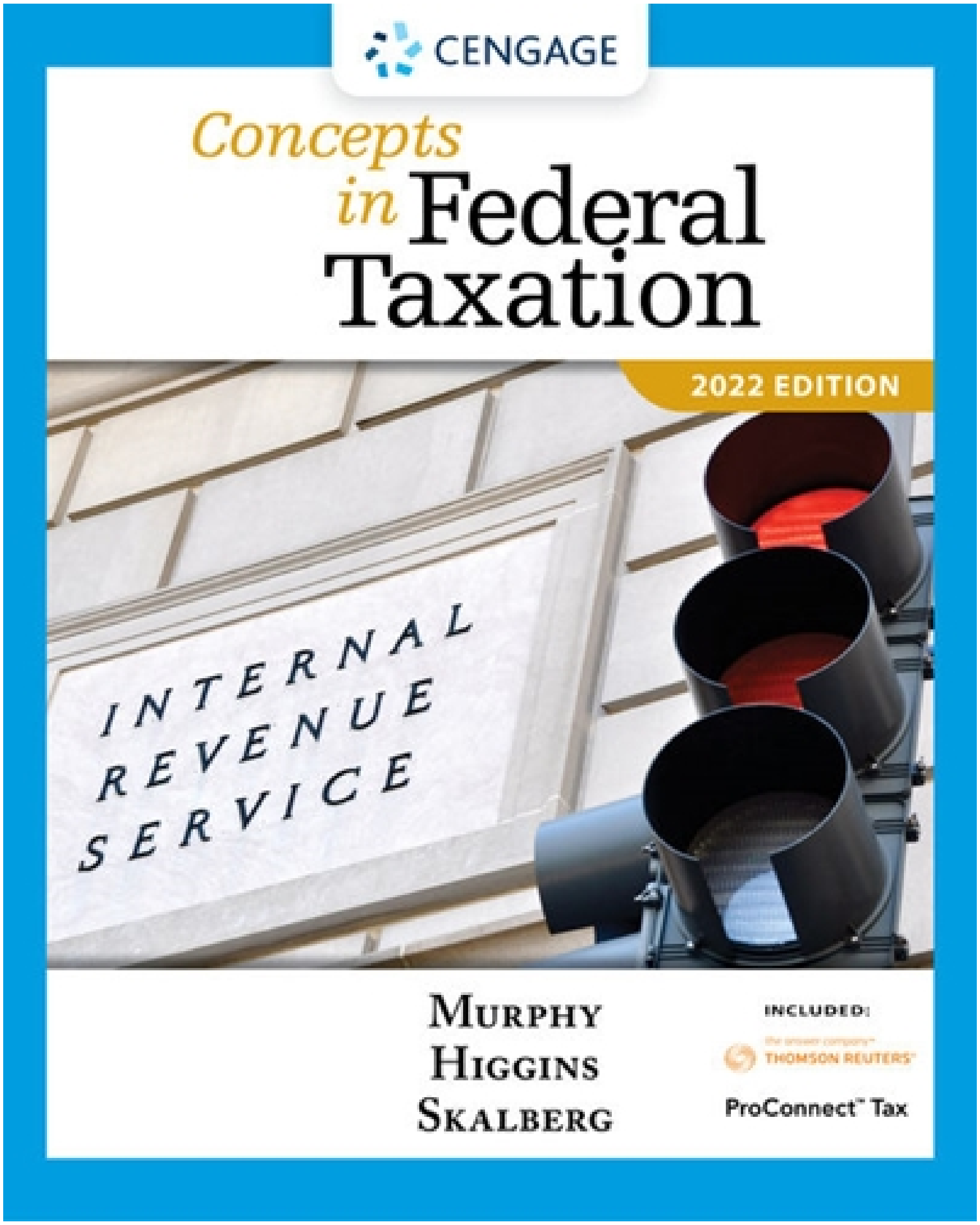

Test Bank

Name:________________________ Class:________________ Date:__________

Chapter_01_Federal_Income_Taxation_An_Overview

1. A tax is an enforced contribution used to finance the functions of government.
   a. True
   b. False

ANSWER: True

2. Adam Smith identified efficiency, certainty, convenience, and economy as the four basic requirements for a good tax system.
   a. True
   b. False

ANSWER: False

3. Congress is required to ensure that the tax law has the following characteristics: equality, certainty, convenience, and economy.
   a. True
   b. False

ANSWER: False

4. Horizontal equity exists when two similarly situated taxpayers are taxed the same.
   a. True
   b. False

ANSWER: True

5. The marginal tax rate is the rate of tax that will be paid on the next dollar of income or the rate of tax that will be saved by the next dollar of deduction.
   a. True
   b. False

ANSWER: True

6. A regressive tax rate structure is defined as a tax in which the average tax rate decreases as the tax base increases.
   a. True
   b. False

ANSWER: True

7. Employers are required to pay a federal unemployment tax of 6.2% of the first $10,000 in wages to each employee less a credit of up to 5.4% of state unemployment taxes paid.
   a. True
   b. False

ANSWER: False

8. A deferral is like an exclusion in that it does not have a current tax effect. However, it differs in that an exclusion is never subject to tax, whereas a deferral will be subject to tax at some point of time in the future.
   a. True
   b. False

ANSWER: True

9. An annual loss results from an excess of allowable deductions for a tax year over the reported income for the year.

a. True

b. False

ANSWER: True

10. Self-employed people are required to make quarterly payments of their estimated tax liability.

a. True

b. False

ANSWER: True

11. The statute of limitations is three years, and it runs for six years if a taxpayer omits gross income in excess of 25% of the gross income reported on the return. There is no statute of limitations if the taxpayer willfully defrauds the government.

a. True

b. False

ANSWER: True

12. Gifts to qualified charitable organizations may be deducted as a charitable contribution, but it may not exceed 50% of a taxpayer's adjusted gross income.

a. True

b. False

ANSWER: False

13. Tax avoidance occurs when a taxpayer uses fraudulent methods or deceptive behavior to hide actual tax liability.

a. True

b. False

ANSWER: False

14. All tax practitioners are governed by the AICPA's Code of Professional Conduct.

a. True

b. False

ANSWER: False

15. A CPA may prepare tax returns using estimates provided by the taxpayer if it is impracticable to obtain exact data and the estimates are reasonable.

a. True

b. False

ANSWER: True

16. According to the IRS definition, which of the following is ***not*** a characteristic of a tax?

a. The payment to the governmental authority is required by law.

b. The payment relates to the receipt of a specific benefit.

c. The payment is required pursuant to the legislative power to tax.

d. The purpose of requiring the payment is to provide revenue to be used for public or governmental purposes.

ANSWER: b

17. Which of the following payments would ***not*** be considered a tax?
   a. An assessment based on the selling price of the vehicle
   b. A local assessment for new sewers based on the amount of water used
   c. A local assessment for schools based on the value of the taxpayer's property
   d. A surcharge based on the amount of income tax already calculated

ANSWER: b

18. Based on the definition given in Chapter 1 of the text, which of the following is a tax?
I. A registration fee paid to the state to get a car license plate
II. Two percent special sales tax for funding public education
III. A special property tax assessment for installing sidewalks in the taxpayer's neighborhood
IV. An income tax imposed by Chicago on persons living or working within the city limits
   a. Only statement I is correct.
   b. Only statement III is correct.
   c. Only statement IV is correct.
   d. Statements I and IV are correct.
   e. Statements II and IV are correct.

ANSWER: e

19. Which of the following payments meets the IRS definition of a tax?
   a. A fee paid on the value of property transferred from one individual to another by gift
   b. A one-time additional property tax assessment to add a sidewalk to the neighborhood
   c. A fee paid on the purchase of aerosol producing products to fund ozone research
   d. A fee for a sticker purchased from a city that must be attached to garbage bags before the city garbage trucks pick up the bags.
   e. All of the above meet the definition of a tax.

ANSWER: a

20. Which of the following payments is a tax?
I. Artis paid the IRS a penalty of $475 (above his $11,184 income tax balance due) because he had significantly underpaid his estimated income tax.
II. Lindsey paid $135 to the state of Indiana to renew her CPA license.
III. Carrie paid a $3.50 toll to cross the Mississippi River.
IV. Darnell paid $950 as property tax that applies to all property owners, and all school children will benefit from it.
   a. Only statement IV is correct.
   b. Only statement III is correct.
   c. Statements II and IV are correct.
   d. Statements I, II, and III are correct.
   e. Statements I, II, III, and IV are correct.

ANSWER: a

21. Which of the following payments constitutes tax as defined by the IRS?
   a. Sewer fee charged added to a city trash collection bill
   b. A special assessment paid to the county to pave a street

c. A levy on the value of a deceased taxpayer's estate

d. Payment of $300 to register an automobile; the $300 consists of a $50 registration fee, and $250 is based on the weight of the auto

ANSWER: c

22. Which of the following statement(s) is/are included in Adam Smith’s four requirements for a good tax system?

I. Changes in the tax law should be made as needed to raise revenue and for proper administration.
II. A tax should be imposed in proportion to a taxpayer's ability to pay.
III. A taxpayer should be required to pay a tax when it is most likely to be convenient for the taxpayer to make the payment.
IV. The government must collect taxes equal to its expenses.

a. Statements I and II are correct.
b. Statements I and IV are correct.
c. Statements II and III are correct.
d. Statements II and IV are correct.
e. Statements III and IV are correct.

ANSWER: c

23. Which of the following are included among Adam Smith's criteria for evaluating a tax?

I. Convenience
II. Fairness
III. Neutrality
IV. Economy

a. Statements I and II are correct.
b. Statements I, II, and III are correct.
c. Statements I and IV are correct.
d. Statements II and III are correct.
e. Statements I, II, III, and IV are correct.

ANSWER: c

24. 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. certainty.
b. transparency
c. equality.
d. neutrality.
e. fairness.

ANSWER: a

25. Which of Adam Smith's requirements for a good tax system best supports the argument that the federal income tax rate structure should be progressive?

a. Certainty
b. Convenience
c. Equality
d. Neutrality

e. Sufficiency

ANSWER: c

26. Pay-as-you-go withholding is consistent with Adam Smith's criteria of:

a. certainty.

b. convenience.

c. economy.

d. fairness.

e. transparency.

ANSWER: b

27. Adam Smith's concept of vertical equity is found in a tax rate structure that is:

a. regressive.

b. proportional.

c. horizontal.

d. progressive.

e. economical.

ANSWER: d

28. Vertical equity:

I.	means that those taxpayers who have the greatest ability to pay the tax should pay the greatest proportion of the tax.
II.	means that two similarly situated taxpayers are taxed the same.
III.	is reflected in the progressive nature of the federal income tax system.
IV.	exists when Avis, a single individual with 4 dependent children, and Art, a single individual with no dependents, both pay $2,400 income tax on equal $26,000 annual salaries.

a. Statements III and IV are correct.

b. Statements II and III are correct.

c. Statements I and III are correct.

d. Only statement IV is correct.

e. Statements I, II, III, and IV are correct.

ANSWER: c

29. Horizontal equity:

I.	means that those taxpayers who have the greatest ability to pay the tax should pay the greatest proportion of the tax.
II.	means that two similarly situated taxpayers are taxed the same.
III.	exists when Michael and Sam each earn $12,000 a year and pay $1,200 in tax.
IV.	exists when Avis, a single individual with 4 dependent children, and Art, a single individual with no dependents, both pay $2,400 income tax on equal $26,000 annual salaries.

a. Statements III and IV are correct.

b. Statements II and III are correct.

c. Statements I and III are correct.

d. Only statement IV is correct.

e. Statements I, II, III, and IV are correct.

ANSWER: b

30. If a taxpayer has a choice of receiving income in the current year versus the following 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

ANSWER: d

31. Jessica is single and has a 2021 taxable income of $203,300. She also received $15,000 of tax-exempt income. Jessica's marginal tax rate is:

a. 21.1%.

b. 22.0%.

c. 22.7%.

d. 32.0%.

e. 35.0%.

ANSWER: d

32. Andrea is single and has a 2021 taxable income of $203,300. She also received $15,000 of tax-exempt income. Andrea's average tax rate is:

a. 21.5%.

b. 22.0%.

c. 22.6%.

d. 32.0%.

e. 35.0%.

ANSWER: c

33. Maria is single and has a 2021 taxable income of $203,300. She also received $15,000 of tax-exempt income. Maria's effective tax rate is:

a. 21.5%.

b. 22.0%.

c. 22.6%.

d. 32.0%.

e. 35.0%.

ANSWER: a

34. Bob and Linda are married taxpayers filing jointly and have a 2021 taxable income of $271,050. They also received $20,000 of tax-exempt income. Their marginal tax rate is:

a. 18.3%.

b. 19.6%.

c. 22.0%.

d. 24.0%.

e. 32.0%.

ANSWER: d

35. Frank and Fran are married taxpayers filing jointly and have a 2021 taxable income of $271,050. They also received $20,000 of tax-exempt income. Their average tax rate is:

a. 18.3%

b. 19.6%

c. 22.0%

d. 24.0%

e. 32.0%

ANSWER: b

36. Jim and Anna are married taxpayers filing jointly and have a 2021 taxable income of $271,050. They also received $20,000 of tax-exempt income. Their effective tax rate is:

a. 18.3%.

b. 19.6%.

c. 22.0%.

d. 24.0%.

e. 32.0%.

ANSWER: a

37. Terry is a worker in a country named Pretoria. His salary is $46,000, and his taxable income is $52,000. Pretoria imposes a worker tax as follows:

Employers withhold a tax of 20% of all wages and salaries. If taxable income as reported on the employee's income tax return is greater than $50,000, an additional 10% tax is withheld on all income. Terry's marginal tax rate is:

a. 0%.

b. 10%.

c. 20%.

d. 30%.

ANSWER: d

38. The mythical country of Januvia imposes a tax based on the number of titanium coins each taxpayer owns at the end of each year per the following schedule:

Number of titanium coins	Tax
0 – 200	$500 + $5 per titanium coin
201 – 500	$1,000 + $6 per titanium coin
> 500	$4,000 + $7 per titanium coin

Marvin, a resident of Januvia, owns 300 titanium coins at the end of the current year.

I. Marvin's titanium coins tax is $2,800.

II. Marvin's marginal tax rate is $6.

III. Marvin's average tax rate is $9.33.

IV. Marvin's average tax rate is $6.

a. Statements II and III are correct.

b. Statements I, II, and IV are correct.

c. Statements II and IV are correct.

d. Statements I, II, and III are correct.

e. Only statement II is correct.

ANSWER: d

39. Jaun plans to give $5,000 to the American Diabetes Association. Jaun's marginal tax rate is 24%. His average tax rate is 21%. Jaun itemizes his deductions. The after-tax cost Juan's contribution is:

a. $3,250.

b. $3,400.

c. $3,800.

d. $3,950.

e. $5,000.

ANSWER: c

40. Katie pays $10,000 in tax-deductible property taxes. Katie’s marginal tax rate is 32%, average tax rate is 28%, and effective tax rate is 25%. Katie's tax savings from paying the property tax is:

a. $1,600.

b. $2,500.

c. $2,800.

d. $3,200.

e. $10,000.

ANSWER: d

41. Lee's 2021 taxable income is $110,000 before considering charitable contributions. Lee is a single individual. She makes a donation of $20,000 to the American Heart Association in December 2021. By how much did Lee's marginal tax rate decline simply because of the donation?

a. 0%

b. 10%

c. 3%

d. 5%

e. 8%

ANSWER: a

42. Shara's 2021 taxable income is $41,000 before considering charitable contributions but subtracting other itemized deductions of $14,000. Shara is a single individual. She makes a fully deductible donation of $5,000 to the American Heart Association in December 2021. By how much did Shara's marginal tax rate decline simply because of the donation?

a. 0%

b. 7%

c. 3%

d. 5%

e. 10%

ANSWER: e

43. Sally is a single individual. In 2021, she receives $20,000 of tax-exempt income in addition to her salary and other investment income of $100,000. Sally's 2021 tax return showed the following information:

Gross income	$100,000
Deductions for adjusted gross income	(4,000)
Adjusted gross income	$96,000
Itemized deductions	(16,000)
Taxable income	$80,000
Total tax	$13,349
Less: Income tax withheld from wages	(13,590)
Refund	$241

Which of the following statements concerning Sally's tax rates is (are) correct?
I. Sally's average tax rate is 16.7%.
II. Sally's average tax rate is 13.3%.
III. Sally's marginal tax rate is 22%.
IV. Sally's marginal tax rate is 24%.

a. Statements I and III are correct.
b. Statements I and IV are correct.
c. Statements II and III are correct.
d. Statements II and IV are correct.
e. Only statement IV is correct.

ANSWER: a

44. Jered and Samantha are married. Their 2021 taxable income is $95,000 before considering a $10,000 deduction for adjusted gross income (AGI). What is the tax savings attributable to their deduction?

a. $0
b. $1,200
c. $2,200
d. $2,400
e. $10,000

ANSWER: c

45. Betty is a single individual. In 2021, she receives $5,000 of tax-exempt income in addition to her salary and other investment income. Betty's 2021 tax return showed the following information:

Gross income	$90,000
Deductions for adjusted gross income	(4,000)
Adjusted gross income	$86,000
Itemized deductions	(14,400)
Taxable income	$71,600
Income tax	$11,501
Less: Income tax withheld from wages	(11,701)
Refund	$200

Which of the following statements concerning Betty's tax rates is (are) correct?
I. Betty's average tax rate is 16.1%.
II. Betty's average tax rate is 15.0%.
III. Betty's effective tax rate is 16.1%.
IV. Betty's effective tax rate is 15.0%.

a. Statements I and III are correct.
b. Statements I and IV are correct.
c. Statements II and III are correct.
d. Statements II and IV are correct.

ANSWER: b

46. Katarina, a single taxpayer, has total income from all sources of $100,000 for 2021. Her taxable income after taking into consideration $25,000 in deductions and $10,000 in exclusions is $65,000. Katarina’s tax liability is $10,049. What are Katarina's marginal, average, and effective tax rates?

a. 12% marginal; 15.5% average; 13.4% effective.
b. 22% marginal; 15.5% average; 15.5% effective.
c. 24% marginal; 13.4% average; 15.5% effective.
d. 22% marginal; 15.5% average; 13.4% effective.
e. 12% marginal; 13.4% average; 15.5% effective.

ANSWER: d

47. Alan is a single taxpayer with a gross income of $88,000, a taxable income of $66,000, and an income tax liability of $10,269 for 2021. Alan also has $8,000 of tax-exempt interest income. What are Alan's marginal, average, and effective tax rates?

a. 22% marginal; 13.9% average; 15.6% effective.
b. 24% marginal; 13.9% average; 15.6% effective.
c. 12% marginal; 15.6% average; 13.9% effective.
d. 22% marginal; 15.6% average; 13.9% effective.

ANSWER: d

48. A tax provision has been discussed that would add an additional marginal tax rate of 42% to be applied to an individual's taxable income in excess of $800,000. If this provision were to become law, what overall distributional impact would it have on our current income tax system?

a. Proportional
b. Regressive
c. Progressive
d. Disproportional
e. None of the above

ANSWER: c

49. The Federal income tax is a:

a. revenue neutral tax.
b. regressive tax.
c. value-added tax.
d. progressive tax.
e. form of sales tax.

ANSWER: d

50. A state sales tax levied on all goods and services sold is an example of a:

a. progressive tax.

b. regressive tax.

c. proportional tax.

d. value added tax.

ANSWER: c

51. Indicate which of the following statements concerning the following tax rate structures is/are correct.

	When Income Equals	Total Tax Equals
Structure #1	10,000	600
	100,000	5,000
Structure #2	15,000	900
	75,000	4,500
Structure #3	13,000	975
	86,000	6,600

I. Tax Structure #1 is proportional.
II. Tax Structure #1 is regressive.
III. Tax Structure #2 is progressive.
IV. Tax Structure #3 is progressive.

a. Only statement I is correct.

b. Only statement III is correct.

c. Statements I and II are correct.

d. Statements II and IV are correct.

e. Statements I, II, and IV are correct.

ANSWER: d

52. Indicate which of the following statements concerning the following tax rate structures is/are correct.

	When Income Equals	Total Tax Equals
Structure #1	10,000	750
	100,000	6,000
Structure #2	15,000	900
	75,000	4,000
Structure #3	13,000	1,200
	86,000	9,600

I. Tax structure #1 is regressive.
II. Tax structure #1 is proportional.
III. Tax structure #2 is progressive.
IV. Tax structure #3 is progressive.

a. Only statement I is correct.

b. Only statement III is correct.

c. Statements I and IV are correct.

d. Statements II and IV are correct.

e. Statements I, II, and IV are correct.

ANSWER: c

53. Taxpayer A pays a tax of $3,300 on a taxable income of $10,000 while taxpayer B pays a tax of $6,600 on $20,000. The tax is a:

a. proportional tax.

b. regressive tax.

c. progressive tax.

d. vertical tax.

ANSWER: a

54. The mythical country of Traviola imposes a tax based on the number of gold tokens each taxpayer owns at the end of each year per the following schedule:

Number of Tokens	Tax
0 – 200	$100 + $5 per Token
201 – 500	$1,000 + $6 per Token
> 500	$4,000 + $7 per Token

Traviola's token tax is a

a. proportional tax.

b. regressive tax.

c. progressive tax.

d. value-added tax.

ANSWER: c

55. The mythical country of Woodland imposes two taxes:
Worker tax: Employers withhold ten percent of all wages and salaries. If taxable income as reported on the employee's income tax return is greater than $40,000, an additional 5% tax is levied on all income.

Business tax: All businesses pay a tax on invested capital based on a valuation formula. The tax computed for three different amounts of invested capital is provided below:

Invested Capital	Tax
$100,000	$12,000
$200,000	$16,000
$300,000	$20,000

According to the definitions in the text:

I. the worker tax is a regressive tax rate structure.
II. the business tax is a progressive tax rate structure.
III. the worker tax is a progressive tax rate structure.
IV. the business tax is a regressive tax rate structure.

a. Statements I and III are correct.

b. Statements II and III are correct.

c. Only statement III is correct.

d. Statements I and IV are correct.

e. Statements III and IV are correct.

ANSWER: e

56. Oliver pays a sales tax of $7.20 on the purchase of a lamp for $120. Michelle pays a sales tax of $9 on the purchase of a similar lamp for $150. Oliver's taxable income for the current year is $40,000. Michelle's taxable income is $55,000.

I. The structure of the sales tax is regressive if it is based on taxable income.
II. The structure of the sales tax is proportional if it is based on sales price.
III. The structure of the sales tax is progressive if it is based on taxable income.
IV. The average sales tax paid based on taxable income equals the marginal tax rate for this tax.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements III and IV are correct.
d. Statements II and IV are correct.
e. Statements I, II, and IV are correct.

ANSWER: e

57. Greg pays a sales tax of $7.20 on the purchase of a lamp for $120. Michelle pays a sales tax of $9 on the purchase of a similar lamp for $150. Greg's taxable income for the current year is $40,000. Michelle's taxable income is $55,000.

I. The structure of the sales tax is progressive if it is based on taxable income.
II. The structure of the sales tax is proportional if it is based on sales price.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. None of the statements are correct.

ANSWER: b

58. Heidi and Anastasia are residents of the mythical country of Wetland. Heidi pays a $1,500 income tax on a taxable income of $6,000. Anastasia pays an income tax of $21,000 on a taxable income of $72,000. The income tax structure is:

I. progressive.
II. proportional.
III. regressive.
IV. value-added.
V. marginal.

a. Only statement I is correct.
b. Only statement II is correct.
c. Only statement III is correct.
d. Only statement V is correct.
e. Statements II and IV are correct.

ANSWER: a

59. Elrod is an employee of Gomez, Inc. During 2021, Elrod receives a salary of $120,000 from Gomez. What amount should Gomez withhold from Elrod's salary as payment of Elrod's Social Security and Medicare taxes?

a. $7,440.00

b. $7,803.40

c. $8,422.65

d. $9,087.00

e. $9,180.00

ANSWER: e

60. Marie earns $80,000 as a sales manager for Household Books. How much Social Security and Medicare taxes does Marie have to pay for 2021?

a. $4,960.00

b. $6,120.00

c. $6,400.00

d. $2,240.00

ANSWER: b

61. Samantha is a self-employed electrician. During 2021, her net self-employment income is $120,000. What is Samantha's self-employment tax?

a. $15,570.26

b. $15,606.80

c. $16,832.50

d. $18,174.00

e. $18,360.00

ANSWER: e

62. Rayburn is the sole owner of a dance studio. During the current year, his net self-employment income from the dance studio is $50,000. What is Rayburn's self-employment tax?

a. $3,825.00

b. $5,738.00

c. $6,200.00

d. $7,650.00

ANSWER: d

63. Employment taxes are:

a. revenue neutral.

b. regressive.

c. value-added.

d. progressive.

e. proportional.

ANSWER: e

64. Phyllis is an electrician employed by Bogie Company. Phil is a self-employed electrician. During the current year, Phyllis's salary is $75,000, and Phil's net self-employment income is $75,000. Which of the following statements about the Social Security and self-employment taxes paid is/are correct?

I. Phil's self-employment tax is lesser than the Social Security tax paid on Phyllis's income.

II. Phil pays more self-employment tax than what Phyllis pays in Social Security tax.

III. Phil and Phyllis pay the same amount of tax.
IV. Phil's self-employment tax is equal to the Social Security tax paid on Phyllis's income.

a. Only statement I is correct.
b. Only statement II is correct.
c. Only statement IV is correct.
d. Statements I and III are correct.
e. Statements II and IV are correct.

ANSWER: e

65. Sally is an electrician employed by Bogie Company. Sam is a self-employed electrician. During the current year, Sally's salary is $85,000 and Sam's net self-employment income is $85,000. Which of the following statements about the Social Security and self-employment taxes paid is/are correct?
I. Sam's self-employment tax is greater than the Social Security tax paid on Sally's income.
II. Sam and Sally pay the same amount of tax.

a. Only statement I is correct.
b. Only statement II is correct
c. Both statements are correct
d. None of the statements are correct.

ANSWER: d

66. Sally is an electrician employed by Bogie Company. Sam is a self-employed electrician. During the current year, Sally's salary is $85,000, and Sam's net self-employment income is $85,000. Which of the following statements about the Social Security and self-employment taxes paid is/are correct?
I. Sam pays more self-employment tax than what Sally pays in Social Security tax.
II. Sam's self-employment tax is equal to the Social Security tax paid on Sally's income.

a. Only statement I is correct.
b. Only statement II correct.
c. Both statements are correct.
d. None of the statements are correct.

ANSWER: c

67. How much additional Social Security tax does Elise pay in 2021 on her $10,000 Christmas bonus? Her total earnings for the year (before the bonus) are $170,000.
a. $0
b. $145
c. $620
d. $765

ANSWER: b

68. How much additional Social Security tax does Betty pay in 2021 on her $10,000 Christmas bonus? Her total earnings for the year (before the bonus) are $100,000.
a. $145.00
b. $269.20
c. $461.20

d. $641.00

e. $765.00

ANSWER: e

69. How much additional Social Security tax does Connie pay in 2021 on her $10,000 Christmas bonus? Her total earnings for the year (before the bonus) are $42,000.

a. $ 0

b. $145.00

c. $620.00

d. $765.00

ANSWER: d

70. Which of the following types of taxes rely solely on "income" as the tax base for determining the amount of tax liability?

I. Sales tax
II. Property tax
III. Gift tax
IV. Social Security tax
V. Excise tax

a. Statements I, II, III, IV, and V are correct.

b. Statements I, III, and IV are correct.

c. Statements II and IV are correct.

d. Only statement IV is correct.

e. None of the above types of taxes rely on income for its tax base.

ANSWER: d

71. A property tax

I. is levied on the value of property.
II. is referred to as ad valorem tax.
III. on personal property is more common than a tax on real property.
IV. is based on assessed value rather than actual transactions.

a. Only statement I is correct.

b. Statements II and III are correct.

c. Statements I, II, and IV are correct.

d. Statements I, II, III, and IV are correct.

ANSWER: c

72. When property is transferred, gift and estate taxes are based on the:

a. fair market value of the assets on the date of transfer.

b. replacement cost of the transferred property.

c. transferor's original cost of the transferred property.

d. transferor's adjusted basis of the transferred property.

e. fair market value less adjusted basis on the date of the transfer.

ANSWER: a

73. An excise tax:
I. is levied on the value of property.
II. is levied on the quantity of the product or service.
III. differs from sales tax because the sales tax is imposed on the value of property.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements I and II are correct.
d. Statements II and III are correct.
e. Statements I, II, and III are correct.

ANSWER: d

74. Joy receives a used car worth $13,000 from her uncle as a graduation present. As a result of the gift:
I. Joy will have $13,000 of taxable income.
II. Joy's uncle will be subject to the gift tax.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. None of the statements are correct.

ANSWER: d

75. The term "tax law" as used in your textbook includes:
I. Treasury regulations.
II. college textbooks (i.e., "Concepts in Federal Income Taxes").
III. Internal Revenue Code of 1986.
IV. tax related decisions of a U.S. Circuit Court of Appeals.

a. Only statement III is correct.
b. Statements I, III, and IV are correct.
c. Statements I and III are correct.
d. Only statement II is correct.
e. All four statements are correct

ANSWER: b

76. Ordinary income is:
I. the common type of income that individuals and businesses earn.
II. not bound to receive any special treatment under tax laws.
III. the gain from the sale of shares of stock held more than one year.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements I and II are correct.
d. Statements I and III are correct.
e. Statements I, II, and III are correct.

ANSWER: c

77. Which of the following is a type of IRS examination?
I. Information matching program
II. Office examination
III. Field examination
IV. Revenue agent report

a. Statements II and III are correct.
b. Only statement III is correct.
c. Statements I and IV are correct.
d. Statements I, II, and III are correct.
e. Only statement II is correct.

ANSWER: a

78. The return selection program designed to select returns with the highest probability of errors is:
a. the TCMP.
b. the DIF program.
c. the special audit program.
d. the document perfection program.
e. the information-matching program.

ANSWER: b

79. Christy's 2019 tax return was audited during November 2021 The auditor proposed an additional tax due of $1,500. Christy disagreed. What should Christy do next?
I. Within 30 days, she must file a protest.
II. She must respond with a written protest letter.
III. She may respond with an oral protest.

a. Only statement I is correct.
b. Only statement II is correct.
c. Only statement III is correct.
d. Statements I and III are correct.
e. Statements I and II are correct.

ANSWER: d

80. How long does a taxpayer have to file a petition with the U.S. Tax Court after receiving a Statutory notice of deficiency?
a. 10 days
b. 30 days
c. 90 days
d. 120 days
e. 180 days

ANSWER: c

81. Which of the following is/are the feature(s) of the income tax formula for individual taxpayers?
I. This dichotomy of deductions results in an intermediate income number called adjusted

gross income (AGI).
II. One class of deductions is called exclusions from income.
III. One class of deductions is called deductions for adjusted gross income.
IV. Expenses qualifying as deductions for adjusted gross income are not limited by the income of the taxpayer.

a. Statements III and IV are correct.
b. Statements II and III are correct.
c. Statements I, III, and IV are correct.
d. Only statement IV is correct.
e. Statements I, II, III, and IV are correct.

ANSWER: c

82. The calculation of an individual's income tax includes certain deductions for adjusted gross income. Which of the following is/are example(s) of this class of deductions?
I. Trade or business expenses
II. Rental expenses
III. Up to $2,500 of interest on qualified student loans
IV. Investment interest

a. Statements I and II are correct.
b. Statements I, II, and III are correct.
c. Only statement I is correct.
d. Only statement III is correct.
e. Statements I, II, III, and IV are correct.

ANSWER: b

83. Which of the following statements is/are correct?
I. There is a minimum allowable standard deduction from adjusted gross income of individuals.
II. Corporations are allowed itemized deductions from adjusted gross income.
III. Corporations are allowed a standard deduction.
IV. Trade and business expenses of individuals are deductible from adjusted gross income.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements II and IV are correct.
d. Statements I and IV are correct.
e. Statements I and III are correct.

ANSWER: a

84. Adjusted gross income (AGI):
I. is used to provide limitations on certain deductions from AGI.
II. is unique to the individual income tax formula.
III. is the result before subtracting certain allowable personal expenditures from gross income.

a. Only statement I is correct.

b. Only statement II is correct.

c. Only statement III is correct.

d. Statements I and II are correct.

e. Statements I, II, and III are correct.

ANSWER: e

85. Deductions for adjusted gross income and itemized deductions are two types of reductions used to calculate taxable income. Which of the following is/are characteristic(s) of these types of deductions?

I. Taxpayers can deduct the larger of itemized deductions or the standard deduction.
II. Taxpayers can deduct the larger of deductions for adjusted gross income or the standard deduction.
III. Deductions for adjusted gross income are limited to those incurred in a trade or business, incurred in the earning other forms of income, and certain specifically allowed personal expenses of individuals.

a. Only statement III is correct.

b. Statements I and II are correct.

c. Statements I and III are correct.

d. Statements II and III are correct.

e. Statements I, II, and III are correct.

ANSWER: c

86. For 2021, Nigel and Lola, married taxpayers without children, calculated their total allowable itemized deductions to be $28,100. Accordingly, Nigel and Lola file jointly and should deduct from adjusted gross income:

I. the standard deduction amount of $25,100.
II. total itemized deductions equal to $28,100.
III. the itemized deduction of $28,100 minus the standard deduction of $25,100.
IV. the standard deduction of $25,100 plus the itemized deductions of $28,100.

a. Only statement I is correct.

b. Only statement II is correct.

c. Statements I, III, and IV are correct.

d. Statements II and IV are correct.

e. Statements I, II, III, and IV are correct.

ANSWER: b

87. Which of the following is/are categorized as itemized deduction(s)?

I. Trade or business expenses
II. Rental expenses
III. Property taxes on personal residence
IV. Investment interest expense

a. Only statement I is correct.

b. Only statement IV is correct.

c. Statements I and III are correct.

d. Statements III and IV are correct.

e. Statements I, II, and IV are correct.

ANSWER: d

88. Based on the following information, what is the 2021 taxable income for a married couple with two children?

Total income	$120,000
Excludable income	2,000
Deductions for AGI	5,000
Allowable itemized deductions	8,000

a. $85,000

b. $87,900

c. $92,900

d. $105,000

e. $113,000

ANSWER: b

89. Sonya owes a deductible expense that she can pay either (and deduct) this year or next year. She is in the 24% marginal tax rate bracket. Which of the following statements about this payment is/are correct based on marginal tax rate considerations?

I. Deductions should always be taken as soon as possible. Sonya should pay the expense this year.

II. If Sonya expects to be in the 32% marginal tax rate bracket next year, she should pay the expense this year.

III. If Sonya expects to be in the 12% marginal tax rate bracket next year, she should pay the expense this year.

IV. If Sonya expects to be in the 24% marginal tax rate bracket next year, she should pay the expense this year.

a. Only statement II is correct.

b. Only statement IV is correct.

c. Statements I and III are correct.

d. Statements I and IV are correct.

e. Statements III and IV are correct.

ANSWER: e

90. Sarah owes a deductible expense that she can either pay (and deduct) this year or next year. She is in the 22% marginal tax rate bracket. Which of the following statements about this payment is/are correct based on marginal tax rate considerations?

I. Deductions should always be taken in the current year. Sarah should pay the expense this year.

II. If Sarah expects to be in the 32% marginal tax rate bracket next year, she should pay the expense next year.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. None of the statements are correct.

ANSWER: b

Name:________________________________ Class:____________________ Date:___________

91. Trang is in the 12% marginal tax bracket in the current year. She owes a $10,000 bill for business expenses. Since she reports taxable income on a cash basis, she can deduct the $10,000 either this year or the next year, depending on when she makes the payment. She can pay the bill at any time before January 31 of the next year, without incurring the normal 12% interest charge. She expects to be in the 22% marginal bracket next year. Without considering the time value of money, what are her tax savings if she pays the bill after January 1?

a. Tax savings of $1,000 in the current year

b. Tax savings of $1,200 in the current year

c. Tax savings of $1,000 in the next year

d. Tax savings of $2,200 in the next year

e. Tax savings of $1,200 in the next year

ANSWER: c

92. Tax planning involves the timing of income and deductions. General rules of thumb to follow when planning include:

I. putting income into the year with the lowest expected marginal tax rate.

II. deferring recognition of income.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. None of the statements are correct.

ANSWER: c

93. Tax planning involves the timing of income and deductions. General rules of thumb to follow when planning include:

I. putting income into the year with the lowest expected marginal tax rate.

II. deferring deductions.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. None of the statements are correct.

ANSWER: a

94. Tax planning involves the timing of income and deductions. General rules of thumb to follow when planning include:

I. deferring recognition of income.

II. putting deductions into the year with the highest expected marginal tax rate.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. None of the statements are correct.

ANSWER: c

95. Which of the following is an example of tax evasion?

a. Beth invests money in tax exempt municipal bonds instead of corporate bonds.

b. Bryan uses the cafeteria plan offered by his employer to fund pension plan contributions for his retirement.

c. Bauregard, a very wealthy 87-year-old individual, gives bonds to each of his grandchildren so that the interest income on the bonds would be taxed at a lower tax rate.

d. Bertha won $500 cash in an amateur mud wrestling contest but doesn't report it on her tax return.

e. All of the above are examples of tax evasion.

ANSWER: d

96. Which of the following taxpayers may have used tax evasion tactics when filing their 2021 tax return?

I. Fern, a cash basis accountant, intentionally billed clients for services on December 31, 2021, to avoid receiving cash payments from clients until 2022.
II. Samual made a mathematical mistake on a schedule in his tax return that resulted in a $2,000 underpayment of tax. The IRS does not detect the mistake.
III. Beverly accidentally underreported $800 of the income she earned providing childcare in her home.
IV. Bo, a cattle rancher, deducted the cost of raising seven steers that were used by his family and relatives for food during 2021.

a. Statements I and III are correct.

b. Only statement II is correct.

c. Statements II and III are correct.

d. Statements III and IV are correct.

e. Only statement IV is correct.

ANSWER: e

97. Tax evasion usually involves certain elements. Which of the following are elements necessary for tax evasion to occur?

I. Nondisclosure of the relevant facts on the taxpayer’s tax return
II. Underpayment of tax
III. Using legal methods allowed by the law to minimize a tax liability
IV. Willfulness on the part of the taxpayer
V. An affirmative act by the taxpayer to evade the tax

a. Statements I, II, and III are correct.

b. Statements I, II, IV, and V are correct.

c. Statements I and III are correct.

d. Only statement IV is correct.

e. All of the five listed elements are correct.

ANSWER: b

98. Glenna has put money in savings accounts in 50 different banks. She knows a bank is not required to report to the IRS any interest it pays her that totals less than $10. Because the banks do not report the payments to the IRS, Glenna does not report the interest received as taxable income. Which of the following is/are true?

I. Glenna's action is an act of tax evasion because she intentionally misrepresented facts on a tax return to avoid paying tax.
II. Glenna's action is an act of tax avoidance because the IRS will never know about the interest income.
III. Glenna's action is an act of tax evasion because she took steps to conceal the income.

a. Only statement I is correct.

b. Only statement II is correct.

c. Statements I and III are correct.

d. Statements II and III are correct.

e. Statements I, II, and III are correct.

ANSWER: c

99. Alice is a plumber and collector of rare stamps. Instead of always receiving cash payments for her work, she occasionally has her customers send their payments to a stamp broker. The broker then makes stamp purchases on Alice's behalf and mails the stamps to her. Alice never reports the value of the stamps received as income on her tax return.
I. Alice's actions is a form of tax evasion.
II. Alice's action is subject to payment of tax, interest, and penalty if detected by the IRS.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. None of the statements are correct.

ANSWER: c

100. Betty hires Sam, a CPA, to prepare her current federal income tax return for the first time. In preparing the return, Sam finds an error in last year's return. Sam should:
I. do nothing and see if the IRS catches the error.
II. inform Betty and recommend corrective measures.
III. immediately contact the IRS.
IV. immediately call Betty and tell her he cannot complete this year's return.

a. Only I is correct.

b. Only II is correct.

c. Only III is correct.

d. I and III are correct.

e. I and IV are correct.

ANSWER: b

101. Betty hires Sam, a CPA, to prepare her current federal income tax return. In preparing the return, Sam discovers that he made an error in the preparation of Betty's return for the previous year. Sam should:
I. immediately contact the IRS.
II. tell Betty that they should wait and see if the IRS catches the error.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. None of the statements are correct.

ANSWER: d

102. Betty hires Sam, a CPA, to prepare her current federal income tax return. In preparing the return, Sam incorrectly computes the total of her charitable contributions by accidentally adding the same amount twice. This overstates her deductions and understates her tax liability.
I. Sam is subject to a penalty for the preparation of a fraudulent tax return.
II. Sam is subject to a penalty for having taken an unrealistic tax position.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. None of the statements are correct.

ANSWER: d

103. All tax practitioners who prepare tax returns for a fee are subject to which of the following?
I. IRS Circular 230
II. AICPA Code of Professional Conduct
III. Statements on Standards for Tax Services
IV. American Bar Association Code of Professional Conduct

a. Only statement I is correct.

b. Statements I, II, and III are correct.

c. Statements II and III are correct.

d. Statements II and IV are correct.

e. Statements I, II, III, and IV are correct.

ANSWER: a

104. The AICPA's Statements on Standards for Tax Services (SSTS) have common concepts running through most of them. Which of the following statements is/are part(s) of the SSTSs?
I. The preparer may in good faith rely upon, without verification, information furnished by the client.
II. There is confidentiality of the CPA-client relationship.
III. Taxpayer supplied estimates may be used to prepare returns if it is impractical to obtain exact data and the estimates are reasonable, given the facts and circumstances.
IV. The preparer must never disclose to the IRS any facts about the client's tax return information unless the client approves the disclosure or the preparer is required to do so by law.

a. Only statement II is correct.

b. Statements I, II, and IV are correct.

c. Statements II and III are correct.

d. Statements I, II, and III are correct.

e. Statements I, II, III, and IV are correct.

ANSWER: e

Match each term with the correct statement below.

a. Ad valorem tax

b. Deduction

c. Excise tax

d. Exclusion

e. Expense

f. Gain

g. Loss

h. Ordinary income

i. Pay-as-you-go concept

j. Personal property
k. Real property
l. Self-assessment
m. Standard deduction
n. Statute of limitations
o. Tax base
p. Tax credit

105. Any type of property that is not real property
ANSWER: j

106. Based on a quantity of a product sold
ANSWER: c

107. Based on the value of the property being taxed
ANSWER: a

108. The value or amount that is subject to taxation
ANSWER: o

109. The excess of an asset’s tax basis over its selling price
ANSWER: g

110. Land and any structures permanently attached to it
ANSWER: k

111. The excess of the selling price of an asset over its tax basis
ANSWER: f

112. Used by persons who do not itemize deductions on their return
ANSWER: m

113. Subtractions from gross income specifically allowed by the tax law
ANSWER: b

114. Current period expenditure incurred in order to earn income
ANSWER: e

115. The payment of tax throughout the year close to the time income is earned as is reasonable.
ANSWER: i

116. The common and recurring type of income earned by taxpayers for a year
ANSWER: h

117. A taxpayer is responsible for determining his or her tax liability and paying the tax due timely.
ANSWER: l

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118. Direct reduction in the income tax liability often created by Congress to further a public purpose
ANSWER: p

119. The period of time during which a taxpayer and/or the IRS can correct the taxpayer's taxable income
ANSWER: n

120. Increases in a taxpayer's wealth and recoveries of a taxpayer's capital investment that Congress has decided should not be subject to income tax
ANSWER: d

Match each term with the correct statement below.

a. Average tax rate
b. Effective tax rate
c. Horizontal equity
d. Marginal tax rate
e. Progressive rate structure
f. Proportional rate structure
g. Regressive rate structure
h. Tax avoidance
i. Tax evasion
j. Vertical equity

121. A tax in which the average tax rate increases as the tax base increases
ANSWER: e

122. A tax in which the average tax rate decreases as the tax base increases
ANSWER: g

123. Fraudulent methods are used to reduce the actual tax liability.
ANSWER: i

124. A tax for which the average tax rate remains the same as the tax base increases
ANSWER: f

125. Tax planning using legal methods to minimize the tax liability
ANSWER: h

126. The tax rate that will apply to the next dollar of taxable income
ANSWER: d

127. The tax rate obtained by dividing total tax liability by taxable income
ANSWER: a

128. The tax rate obtained by dividing total federal income tax by the taxpayer's economic income
ANSWER: b

129. It exists when two similarly situated taxpayers are taxed the same.

ANSWER: c

130. It exists when two differently situated taxpayers are taxed differently but fairly in relation to each taxpayer's ability to pay the tax.
ANSWER: j

131. What type of tax rate structure is indicated in the following example? Explain.

When income equals	Total tax equals
$10,000	$300
$75,000	$4,500
$100,000	$8,000

ANSWER: The rate structure is progressive. The marginal tax rate is increasing at each tax level (3%, 6%, and 8%), and the marginal tax rate is greater than the average tax rate at each tax level.

132. On January 4, 2021, Owen died and left ranchland worth $300,000 to his brother, Victor. This transfer was purely donative with no expectation of anything in return. Victor transferred all of this land to his corporation, Circle C Ranch, Inc. Victor is the president and an active employee of the corporation. Victor's salary from the corporation is $40,000 per year. The ranchland is located in Torrent County, Texas. The Torrent Appraisal District appraises the property.

From the facts given above, name six different types of federal, state, or local taxes that might have to be paid, and name the entity that is liable to pay them.
ANSWER: Name at least four of the following:

Type of tax	Entity that pays the tax
Estate (unified transfer)	Executor of Owen's estate
Employment	Circle C Ranch, Inc.
Property (ad valorem)	Circle C Ranch, Inc.
Federal income	Victor, Circle C Ranch, Inc.
State income (franchise/corporate)	Circle C Ranch, Inc.
State income (individual)	Victor
Social Security and Medicare	Victor

When Victor transferred the land, he retained the corporate stock. Transfers to corporations are not gifts. Transfers of property from a shareholder to a corporation controlled by the shareholder generally result in no immediate income taxes to the shareholder or the corporation. The basis in the land would be $300,000 in any case, as it is inherited.

133. Raquel is a recent law school graduate. She is upset by an IRS Revenue agent's report on her income tax return that she must pay an additional $2,000 in tax on last year's income. Raquel tells you that she will take her case all the way to the Supreme Court. What is the probability that Raquel will be able to take her case to the Supreme Court?
ANSWER: It is very unlikely that Raquel will take her case to the Supreme Court. First, the Supreme Court limits its review of tax cases to those of major importance (e.g., a constitutional issue) or to resolve conflicting decisions in the appellate courts. Second, she must first file her case in a trial Court and appeal it to an appellate court before the Supreme Court would hear the case. She may win at one of the lower court levels. Even if she wins in the lower courts, litigating is costly, and she may decide that the expense isn't worth the $2,000 in tax.

134. Mo is a single taxpayer reporting $96,900 of 2021 gross income. In addition, Mo receives $5,000 of tax-exempt interest.

Required: Compute the following:

a. Mo's taxable income is ___________________.
b. Mo's tax liability is _____________________. (Round your final answer to the nearest whole dollar.)
c. Mo's marginal tax rate is _____________________.
d. Mo's average tax rate is _____________________. (Round your answer to one decimal place.)
e. Mo's effective tax rate is _____________________. (Round your answer to one decimal place.)

ANSWER: a. $84,350 = $96,900 – $12,550

b. $14,306 = $4,664.00 + [22% × ($84,350 – $40,525)]

c. 22% from the table

d. 16.7% = $14,306 ÷ $84,350

e. 16.0% = [$14,306 ÷ ($84,350 + $5,000)]

135. Julia is single and earns a salary of $65,000. Her allowable deductions for adjusted gross income total $1,200, and she has $4,200 of allowable itemized deductions. What are Julia’s taxable income and income tax liability for 2021? Round your final answer to the nearest whole dollar.

ANSWER: Julia's taxable income is $51,250, and her tax liability is $7,023.50 {$4,664.00 + [22% × ($51,250 – $40,525)]}.

Salary	$65,000
Deductions for AGI	(1,200)
AGI	$63,800
Deductions from AGI (standard deduction)	(12,550)
Taxable income	$51,250

136. Harriet and Harry are married and have a total gross income of $65,000. Their allowable deductions for adjusted gross income total $1,500, and they have $4,400 of allowable itemized deductions. What are Harriet and Harry's taxable income and income tax liability for 2021?

ANSWER: Harriet and Harry's taxable income is $38,400. They will use the standard deduction instead of itemized deductions. Their tax liability is $4,210 {$1,990 + [12% × ($38,400 – $19,990)]}.

Salary	$65,000
Deductions for AGI	(1,500)
AGI	$63,500
Deductions from AGI (standard deduction)	(25,100)
Taxable income	$38,400

137. Barry has prepared the following 2021 income tax estimate for his sister, Sylvia. Sylvia is single and 32 years old and has no children. Sylvia is an employee of General Motors and rents an apartment. Her only investment is a savings bank account.

Salary	$37,200
Bank interest	750
Taxable income	$37,950
Tax on $37,950 @ 12%	$4,554
Income tax liability	$4,554
Withheld income tax	4,800

Balance due	$246

Identify the errors, if any, in Barry's income tax estimate.
Additional calculations are not required.

ANSWER: Individual standard deduction amount is omitted ($12,550).
Taxable Income is $25,400 [$37,950- $12,550]
Misapplication of the tax rate table [$995.00 + 12% of ($25,400 - $9,950)]
Refund (withholding is greater than the tax)

138. Rosemary is single and works for Big B Corporation. Her only income consists of her Big B salary and interest on a savings account. During the year, she has $400 withheld from her salary for state income taxes and $1,800 for federal income taxes. Her brother provides her with the following calculation of her taxable income and income tax liability:

Salary	$36,000
Interest income	3,100
Less: State tax withheld	(400)
Equals: Gross income	$38,700
Less: Deductions for adjusted gross income	
Standard deduction	(25,100)
Equals: Taxable income	$13,600
Income tax liability ($13,600 × 12%)	$1,632
Less: Federal withholding	(1,800)
Equals: Tax due	$168

Explain the errors that Rosemary's brother has made in calculating her taxable income and/or her income tax liability. A recalculation is not necessary, but you must adequately explain the errors that were made.

ANSWER: State taxes withheld are not deductible for adjusted gross income (itemized deduction); the standard deduction is a deduction from adjusted gross income, not a deduction for adjusted gross income; the standard deduction amount for married taxpayers filing a joint return has been wrongly used; the tax was not properly calculated using the tax rate schedule. When withholding exceeds the tax, there is a refund.

139. In December 2021, Arnold is considering one last financial decision for 2020. He has $5,000 that he would like to spend before the end of the year. His options include donating the money to a qualified charity (and receiving an itemized deduction) or using the money as a down payment on the purchase of $30,000 of equipment for his business. If he purchases the equipment, he will receive an 8% tax credit for the entire purchase price. He does not need the equipment until early next year, so the purchase at this time is not critical. Assume that Arnold is in the 32% marginal tax rate bracket in 2021 and itemizes his deductions. Which option will provide him with the greatest tax benefit? Explain and show any calculations that support your answer.

ANSWER: Arnold receives the greatest tax benefit by purchasing the equipment. The charitable contribution saves $1,600 ($5,000 × 32%) in taxes. The tax credit will reduce his tax liability by $2,400 ($30,000 × 8%). Therefore, the credit results in $800 ($2,400 – $1,600) more tax savings.

140. Dana is considering investing $20,000 in one of two investments. The income from Investment A is $2,300. The income from Investment B is $3,000. The income from Investment A would be received at the end of the current year and

would be excluded from tax. The income from Investment B would also be received at the end of the current year but would be subject to tax in 3 years under a special deferral provision. What would you advise Dana? Discuss the factors that are necessary to determine which of the two investments provides the greater after-tax yield.

ANSWER: Dana should choose the investment with the higher real after-tax return. Investment A is not subject to tax and provides a real after-tax return of $2,300 because it is received now. The $3,000 received from Investment B is received in the same period as Investment A, but it must be reduced by the present value of the tax to be paid in 3 years. Therefore, you need to know Dana's expected marginal tax rate in 3 years and her required rate of return (discount factor) to compute the present value of the tax. The comparison then becomes:

Cash received from Investment B	$3,000
Less: $3,000 × marginal tax rate × PV Factor = Real tax	(XXX)
Equals: Real after-tax return from Investment B	$X,XXX
Real after-tax return from Investment A	$2,300

141. On December 28, 2021, Doris and Dan are considering one last financial decision for 2021, a contribution of $1,000 to the American Diabetes Association. If they make the $1,000 contribution, it will be fully deductible on their 2021 income tax return. Their filing status is married filing jointly. Their 2021 taxable income before this contribution is $150,000. If they make this contribution, what is its after-tax cost?

ANSWER: The after-tax cost is $780, and the 2021 marginal rate is 22%.

142. Barrett and Betina are planning to get married on December 26, 2021. Barrett's salary for 2021 is $42,000, and Betina's salary is $40,000. Barrett pays mortgage interest of $10,200 and property taxes of $3,800. Betina has $400 of charitable contributions. Barrett earns interest of $1,450 on a savings account and makes a deductible for AGI contribution to his IRA of $2,000. Betina makes a $1,000 deductible contribution to her IRA. Amounts withheld for state taxes are $2,900 for Barrett and $2,800 for Betina. Based on the given information, answer the following questions to help Barrett and Betina prepare their 2021 tax return (they will file jointly and have no other dependents):

a. What is their adjusted gross income (AGI) for 2021?
b. What are their taxable income and tax liability?
c. If Barrett and Betina don't get married until January 2022, what are Barrett's taxable income and tax liability?
d. If Barrett and Betina don't get married until January 2022, what are Betina's taxable income and tax liability?
e. From a pure tax standpoint, should Barrett and Betina get married in December or January?

ANSWER: a.

Barrett’s salary	$42,000
Betina’s salary	40,000
Barrett’s interest income	1,450
Barrett’s IRA	(2,000)
Betina’s IRA	(1,000)
Adjusted gross income	$80,450

b.

Adjusted gross income	$80,450
Standard deduction	(25,100)

Taxable income	$55,350

Tax liability: $6,244 = $1,990 + [(12% × ($55,350 – $19,990]

c.

Salary	$42,000
Interest income	1,450
IRA	(2,000)
AGI	$41,450
Itemized deductions:	
Mortgage interest	(10,200)
Property taxes	(3,800)
State taxes withheld	(2,900)
Taxable income	$24,550

Tax liability: $2,747 = $995.00 + [12% × ($24,550 – $9,950)]

d.

Salary	$40,000
IRA	(1,000)
AGI	$39,000
Standard deduction	(12,550)
Taxable income	$26,450

Tax liability: $2,975 = $995.00 + [12% × ($26,450 – $9,875)]

e. Their total tax liability for 2021 would be $6,244 if they get married in December and $5,722 ($2,747 + $2,975) if they get married in January. Therefore, they would reduce their total tax liability by $522 by waiting till January to get married.

143. Jennifer Winfield recently purchased business equipment that qualifies for a new tax incentive. The new incentive allows Winfield to either expense $100,000 of the cost of the equipment or claim a tax credit of 15% of the cost of the equipment. The cost of the equipment is $200,000. If the credit is elected, the first-year depreciation will be $34,000. If Winfield chooses to expense $100,000 of the cost, the first-year depreciation will be $20,000 on the remaining cost. Winfield’s tax rate is either 32% or 37%. Under what conditions should Winfield elect to take the tax credit? Explain and show any calculations to support your answer.

ANSWER: Winfield should elect to take the tax credit option when the tax savings from it is greater than the tax savings under the expense option. Tax credits are direct reductions in the tax liability, and tax savings are not dependent on the taxpayer's marginal tax rate. Deductions reduce taxable income, and their value is a function of the taxpayer's marginal tax rate. Therefore, Winfield’s decision depends on its marginal tax rate in the current year:

	Tax Rate 37%	Tax Rate 32%
Expense option:		
Deduction = $100,000 + $20,000 = $120,000	$44,400	$38,400
Credit Option:		
Value of tax credit = $200,000 × 15%	$30,000	$30,000

Value of $34,000 depreciation deduction	12,580	10,880
Total value	$42,580	$40,880

The tax credit option provides the larger tax savings when the marginal tax rate is 32%. When the marginal tax rate is 37%, the expense option provides larger tax savings.

144. Pedro, a cash basis taxpayer, would like to sell ordinary income property that will result in an increase in his taxable income of $20,000. Pedro also owes $12,000 of property taxes that are deductible. He is flexible and can properly report either or both of the items on his 2021 or 2022 tax return. Pedro expects his marginal tax rate to be 24% for 2021 and 32% for 2022. If the applicable interest rate is 9% (0.917 present value factor for 1 year), when should Pedro report each item? Show your calculations and explain. Round your answers to the nearest whole dollar.

ANSWER: Generally, income should be recognized in the year with the lowest marginal tax rate (2021) and as late as possible (2022). Deductions should be taken in the year with the highest marginal tax rate (2022) and as soon as possible (2021). Because the general rules are in conflict, the present value of the tax payable (tax savings) for each year must be calculated. This results in recognizing the income in 2021 and the deduction in 2022.

		Present Value
Gain-		
Tax on gain in 2021 – $20,000 × 24%		$4,800
Tax on gain in 2022 – $20,000 ×32%	$6,400	
Present value factor	× 0.917	5,869
Real savings from selling in 2021		$1,069
Deduction-		
Tax savings in 2021 – $12,000 × 24%		$2,880
Tax savings in 2022 – $12,000 ×32%	$3,840	
Present value factor	× 0.917	3,521
Real savings from deducting in 2022		$641

145. Ed travels from one construction site to another pursuing his work as an insulator. Because of family problems and being on the road so much, Ed overlooked filing his 2010 tax return. Ed hasn't filed any returns since 2010 because he is afraid the IRS will find the missed returns and put him in jail, and he won't be able to support his family. Ed carefully makes sure that his employers withhold more income tax than is necessary. Ed knows for certain that if he filed the late returns, he would get a tax refund for each of the years. Has Ed evaded the income tax? Explain.

ANSWER: No. Evasion is the willful concealment of certain facts in order to receive a tax benefit. Ed has not evaded; he has just failed to file a return. He is not receiving a tax benefit. In fact, he probably has over-paid his tax liability.

146. Joe Bob operates a gas station / grocery store outside the main entrance to a state park. Joe Bob is very independent and dislikes government interference in his business. He pays all his suppliers in cash as they make deliveries. He deposits customer checks to his bank account but retains cash received in the business to pay his expenses. Inventories are material to determine income, and he values his inventory based on estimation. He keeps a log of daily sales, purchases, and other payouts. When preparing his income tax return, his tax preparer carefully compares his gross profit ratio and net profit to sales ratio to other clients operating similar businesses. The accountant then adjusts Joe Bob's income so that the ratios are greater than those reported by the comparable businesses. In addition, the tax preparer adds a guessed amount, usually $20,000 to $50,000, of undisclosed cash sales that is disclosed on the face of Joe Bob's tax return. Thus, his net profit is increased by the same amount. Joe Bob has never objected to the amount of added income. Has Joe Bob evaded the income tax? Explain.

ANSWER: No. Evasion occurs with an underpayment of income tax. It is not clear that there is an underpayment of tax because of Tony's misrepresentation of facts.

147. Madeline operates a janitorial service. The business is organized as a corporation. She has a crew of 100 employees that clean offices and commercial buildings on a set schedule. Madeline also runs a maid service. Since persons paying for the maid services are individuals, the amounts paid to Madeline are not reported to the IRS. Madeline has developed a tax plan. She will deposit the maid service fees to her personal bank account. As a result, she can draw a smaller salary from the janitorial service. She will pay the maids for their services through the corporation. Since she is not deducting her salary from the corporation to the extent of the maid service fees, she keeps the maid fees, and does not report income from the maid fees. Has Madeline evaded the income tax? Explain.

ANSWER: Yes. Madeline has willfully changed the facts concerning her transactions in order to receive a tax benefit. By not reporting the maid fees in her business, she has willfully evaded taxation, especially since she is deducting the maid salaries.

148. Amy hired Carey, a CPA, to prepare her 2021 federal income tax return. Amy had prepared her own 2020 return. In reviewing her records, Carey discovered that Amy had recorded $5,000 of consulting income she received by check in December 2020 as though it had been received in 2021. What should Carey do about this situation?

ANSWER: Under SSTS No. 6, Carey should inform Amy of the error and recommend that she correct the error. In this case, Amy should file an amended return for 2020 to correct the understatement of income. If Amy will not correct the error, Casey will have to consider whether he should continue to prepare the 2021 return.

149. Monty is a licensed Certified Public Accountant. Last year, he prepared an individual income tax return for Apple Bakeries, Inc. This year Apple Bakeries switched to a different tax return preparer. This year, he is preparing income tax returns for a completely separate business, Cinnamon Roll Bakery, Inc. The owner of Cinnamon Roll asked Monty to give him the tax return data from Apple Bakeries to help estimate the tax liability of Cinnamon Roll Bakery, Inc.

Is there a professional responsibility issue for Monty to consider in satisfying Cinnamon Roll's request? If so, what is the issue?

ANSWER: AICPA Code of Professional Conduct Rule 301 (confidentiality) would not allow Monty to disclose this information without Apple's consent. SSTS NO. 3 allows a CPA to use information from the tax return of another taxpayer if the information would not violate the confidentiality of the relationship and is relevant to and necessary for the preparation of the return. Monty would violate Apple's confidential relationship. In addition, the information does not appear to be relevant or necessary for the preparation of Cinnamon's return.