Income Tax Fundamentals 2023 41st edition Whittenburg Test Bank

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Name:________________________ Class:________________ Date:__________

CH 02 Gross Income and Exclusions

True / False

1. Noncash items received as income must be included in income at their fair market value.
   a. True
   b. False

ANSWER: True

2. Awards, bonuses, and prizes are all included in gross income.
   a. True
   b. False

ANSWER: True

3. Disability benefits are generally taxable to the individual receiving the amounts.
   a. True
   b. False

ANSWER: False

4. The amount in Box 1 of Form W-2 for taxable wages will always equal the amount in Box 3 of Form W-2 for Social Security wages.
   a. True
   b. False

ANSWER: False

5. Amounts received by an employee as reimbursement for medical expenses under a policy provided by the taxpayer's employer are excluded from gross income.
   a. True
   b. False

ANSWER: True

6. If an employer claims a business deduction for group health insurance premiums paid on behalf of his employees, the amount must be included in the employees' gross income.
   a. True
   b. False

ANSWER: False

7. Payments made by an employer for health insurance on behalf of an employee are considered income to the employee at the time the payments are made.
   a. True
   b. False

ANSWER: False

8. Cash allowances for meals or lodging generally must be included in the employee's income.
   a. True
   b. False

ANSWER: True

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9. The value of lodging provided to a professor to enable them to live on the campus so they can have a shorter commute is excluded from gross income.
   a. True
   b. False

ANSWER: False

10. Group term life insurance premiums paid by an employer for insurance amounts less than $50,000 must be included in the employee's income.
   a. True
   b. False

ANSWER: False

11. A "no-additional-cost" service includes only those services in the major line of business in which the employee is employed.
   a. True
   b. False

ANSWER: True

12. The amount of excludable employee reimbursement in 2022 for parking and mass transit costs is $280 per month.
   a. True
   b. False

ANSWER: True

13. An automobile that is received as a prize should be included in the taxpayer's income at its list price rather than its fair market value.
   a. True
   b. False

ANSWER: False

14. Basketball superstar Kawhi Leonard's outstanding player award is not includible in income since the award is in recognition of his outstanding performance.
   a. True
   b. False

ANSWER: False

15. If an annuitant, whose annuity starting date was January 1, 2008, dies before recovering their investment in the annuity, any unrecovered investment is recognized as a miscellaneous itemized deduction on the annuitant's tax return for the year of death.
   a. True
   b. False

ANSWER: True

16. Payments made to a qualified retirement plan by an employer are considered part of the employee's investment in the contract for calculation of the annuity exclusion ratio.
   a. True
   b. False

ANSWER: False

17. When calculating the exclusion ratio for an annuity, the ratio should be revised when there is a significant change in the taxpayer's status or health.
    a. True
    b. False

ANSWER: False

18. If a life insurance policy is transferred to the insured's partnership for valuable consideration, the insurance proceeds are taxable when received by the partnership.
    a. True
    b. False

ANSWER: False

19. Interest income received by a cash basis taxpayer is generally reported for the tax year in which it was received.
    a. True
    b. False

ANSWER: True

20. Interest on U.S. Treasury bonds is exempt from taxes.
    a. True
    b. False

ANSWER: False

21. Taxpayers must report interest income on Series EE savings bonds as the interest accrues.
    a. True
    b. False

ANSWER: False

22. A gift received from a financial institution for opening a bank account is not taxable income to the recipient.
    a. True
    b. False

ANSWER: False

23. Interest earned on bonds issued by a state government is fully taxable.
    a. True
    b. False

ANSWER: False

24. To promote business activity, the tax rules generally are very liberal in treating business gifts as tax-free income to the recipient.
    a. True
    b. False

ANSWER: False

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25. The receipt of an inheritance is excluded from the taxable income of the recipients.
    a. True
    b. False

ANSWER: True

26. Dividend income arising from stock received as a gift is excluded from gross income since the dividends are considered part of the gift.
    a. True
    b. False

ANSWER: False

27. Amounts received as scholarships for books and tuition may be excluded from the recipient's taxable income.
    a. True
    b. False

ANSWER: True

28. A scholarship for room and board is fully taxable to the recipient.
    a. True
    b. False

ANSWER: True

29. Child support payments are deductible by the spouse making the payments.
    a. True
    b. False

ANSWER: False

30. If a divorce agreement executed in 2017 specifies that a portion of the amount of an alimony payment is contingent upon the status of a child, that portion is considered to be a child support payment.
    a. True
    b. False

ANSWER: True

31. Under a divorce agreement executed before 2018, periodic payments of either cash or property must be made at regular intervals to be deductible as alimony.
    a. True
    b. False

ANSWER: False

32. In 2022, unemployment compensation is fully taxable to the individual receiving the compensation.
    a. True
    b. False

ANSWER: True

33. In some cases, Social Security benefits may be partially taxable.
    a. True

b. False

ANSWER: True

34. In all community property states, income from community property is community income.
    a. True
    b. False

ANSWER: True

35. New York is a community property state.
    a. True
    b. False

ANSWER: False

36. About two-thirds of the states are community property states.
    a. True
    b. False

ANSWER: False

Multiple Choice

37. Which of the following must be included in the gross income of the recipient in 2022?
    a. Child support payments
    b. Welfare payments
    c. Gifts
    d. Unemployment compensation

ANSWER: d

38. Which of the following is excluded from gross income?
    a. Gambling winnings
    b. Partnership income
    c. Workers' compensation
    d. Jury duty fees

ANSWER: c

39. Which of the following amounts is included in gross income?
    a. Tips and gratuities
    b. Child support payments
    c. Scholarship grants for tuition
    d. Veterans' benefits

ANSWER: a

40. Which of the following is generally excluded from gross income?
    a. Dividends
    b. Rewards

c. Life insurance proceeds

d. Retirement pay

ANSWER: c

41. Which of the following is excluded from gross income?

a. Rents

b. Scholarships for books

c. Hobby income

d. Clergy fees

ANSWER: b

42. Which of the following is classified as nontaxable income in 2022?

a. Unemployment compensation

b. Dividend income

c. Income from real estate rental property

d. Welfare payments

ANSWER: d

43. In the tax law, the definition of gross income is all _____.

a. cash payments received unless excluded by the tax code

b. cash payments received for services performed

c. income from whatever source derived

d. income of any kind unless the income is earned illegally

ANSWER: c

44. Which of the following is excluded from taxable income?

a. Employee bonuses

b. Notary fees

c. Interest

d. Child support payments

ANSWER: d

45. In 2022, which of the following is excluded from taxable income to the recipient?

a. Royalties

b. Estate and trust income

c. Salaries

d. Inheritances

ANSWER: d

46. Mary received the following items during 2022:

Year-end bonus from her employer	$600
Birthday gift from her father	100
Unemployment compensation	35

What is the total amount of the above items that must be included in Mary's current year gross income?

a. $0
b. $635
c. $735
d. $600

ANSWER: b

47. As a year-end thank you for being a good employee, A-One TV Repair gave 62-year-old Aneesha three shares of its stock worth $20 per share. Aneesha then received dividends of $1 per share related to the stock. How much should be included in Aneesha's gross income?

a. $0
b. $3
c. $60
d. $63

ANSWER: d

48. Which of the following is nontaxable income to the recipient for tax purposes?

a. Salary income
b. Income from real estate rental property
c. Income from tips
d. Municipal bond interest

ANSWER: d

49. Box 12 of Form W-2 is used for which of the following?

a. State wages, tips, etc.
b. Taxpayer identification numbers for the employee's dependents
c. Various amounts that may have affected Box 1 wages
d. Tax withheld from wages during the year

ANSWER: c

50. Faisal works for American Motors. American Motors paid a $1,200 premium on Faisal's health insurance in 2022. Faisal had an operation on his foot in 2022 that cost $7,200. The insurance company paid for $6,800 of it. Which one of the following is *true* for 2022?

a. Faisal must claim the $1,200 premium paid by his employer as income.
b. Faisal must claim the $6,800 paid by the insurance company for the operation as income.
c. Faisal must claim the $1,200 premium and the $6,800 insurance payment as income.
d. None of these events are taxable on his 2022 return.

ANSWER: d

51. Anthony is a marine biologist who spends months living on a boat in the ocean studying the impact of runoff water a hundred miles off the coast as a part of his job. Which of the following sentences is the most accurate?

a. Lodging is included in his income, but meals may be excluded.
b. He may exclude meals from his income, but not the fuel used to power the boat.
c. The fuel used to power the boat is excluded from his income, but his meals are included.
d. His meals, lodging, and cost of fuel are all excluded from his income.

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ANSWER: d

52. In which of the following cases may the employee exclude the meals and/or lodging from their taxable income?
    a. A taxpayer lives rent-free at the property they manage even though the owner does not require the manager to live on site.
    b. A headmaster at a boarding school is required to be on campus all night.
    c. A president of a major film studio receives a cash allowance to live in Beverly Hills.
    d. An employee has an option of dining in an all-expense paid employer-sponsored cafeteria or dining out of the office.

ANSWER: b

53. Employer-provided spending accounts ______.
    a. may be set up for tax-free vacation savings
    b. are not allowed for dependent care
    c. do not require that the employee provide receipts for the expenses incurred
    d. allow qualifying expenses to be treated as tax-free reductions in the employee salaries

ANSWER: d

54. Indicate which of the following statements is *true*.
    a. Dependent care plans can *only* be used to cover the costs of caring for a dependent child.
    b. Health care flexible spending accounts can be used to cover dentist fees.
    c. Public transportation may be covered by an employer-provided spending account, but parking cannot be covered.
    d. Dependent care accounts may include day care but not preschool.

ANSWER: b

55. Which of the following is correct?
    a. Employee discounts are always included in gross income.
    b. Employee discounts of up to 20 percent may be taken on personal property held for investment.
    c. Employee discounts are not tax-free if they exceed the employer's gross markup for merchandise.
    d. Tax-free employee discounts include discounts in lines of business in which the employee does not work.

ANSWER: c

56. Which of the following fringe benefits is taxable to the employee receiving the benefit?
    a. A subscription to a tax journal provided by the employer to a corporation's tax accountant
    b. A small discount on toys granted to the salesperson for a toy store
    c. Incidental use of the company's copier by an office worker
    d. A 15 percent discount on investment real estate granted to the employee of a real estate developer

ANSWER: d

57. Which of the following is excludable as an employee fringe benefit?
    a. Employee deductions of $5,200 for dependent child care expenses
    b. Premiums for up to $75,000 of group term life insurance
    c. An employee discount that permits the sale of merchandise to employees for just under cost

d. Public transportation costs of $1,000 per year provided by the employer

ANSWER: d

58. Abran is a 19-year-old full-time student at Claremont College and is a candidate for a bachelor's degree. During 2022, he received the following amounts:

Tuition scholarship	$2,400
Loan from college financial aid office	1,000
Cash support from parents	2,000
Ordinary cash dividend	200
Cash prize awarded from a contest	300

What is his adjusted gross income for 2022?

a. $300

b. $500

c. $2,300

d. $2,500

ANSWER: b

59. Mariah had a good year. She received the following prizes and awards:
An iPad from *The Famous Daytime Talk Show* with a fair market value of $500
Lottery winnings of $1,000 received in cash
A plaque worth $25 plus $100 of Godiva chocolate in recognition for 100 days on the job without an accident
A $10,000 cash prize from *American Idol*

How much of her prizes and awards should Mariah report on her tax return?

a. None, they are all excluded from income.

b. $11,000; only prizes and winnings received as cash are included.

c. $11,500; the award from her job is excluded.

d. $11,600; the plaque may be excluded.

ANSWER: c

60. Which of the following gifts or prizes would be considered taxable income to the person receiving the gift?

a. $5,000 given to the taxpayer by their friend

b. A mobile home given to the taxpayer by their mother

c. A ski boat won by the taxpayer on a game show

d. A Mustang GT given to the taxpayer by their brother

ANSWER: c

61. Rashad, who retired on April 30, 2022, receives a monthly employee annuity benefit of $1,400 payable for life, beginning May 1, 2022. During his years of employment, Rashad contributed $29,400 to the company's plan. Rashad's age on May 1 is 66. Using the simplified method, how much of the $11,200 annuity payment received during 2022 may Rashad exclude from gross income?

a. $427

b. $1,120

c. $1,680

d. $11,200

ANSWER: b

62. Sanjay died on January 15, 2014, and left his spouse, Piper, an insurance policy with a face value of $100,000. Piper elected to receive the proceeds over a 10-year period ($10,000 plus interest each year). This year, Piper receives $11,500 ($10,000 proceeds plus $1,500 interest) from the insurance company. How much income must Piper report from this payment?

a. $0

b. $500

c. $1,500

d. $11,500

ANSWER: c

63. Milo named his wife, Khia, the beneficiary of a $100,000 insurance policy on his life. The policy provided that, upon his death, the proceeds would be paid at a rate of $4,000 per year plus interest over a 25-year period. Milo died June 25 of last year, and in the current year, Khia received a payment of $5,200 from the insurance company. What amount should she include in her gross income for the current year?

a. $200

b. $1,200

c. $4,000

d. $5,200

ANSWER: b

64. Which of the following would result in life insurance proceeds that are taxable to the recipient?

a. A life insurance policy transferred to a creditor in payment of a debt

b. A life insurance policy in which the insured is the daughter of the taxpayer and the beneficiary is the taxpayer

c. A life insurance policy transferred by a shareholder to a corporation

d. A life insurance policy purchased by a taxpayer insuring their business partner

ANSWER: a

65. In 2022, Uriah received the following interest payments:

Interest of $300 on an overpayment of 2012 Federal income taxes
Interest of $400 from his bank certificate of deposit
Interest of $1,000 on municipal bonds
Interest of $1,500 on U.S. savings bonds (Series HH)

What amount, if any, should Uriah report as taxable interest income on his 2022 individual income tax return?

a. $400

b. $700

c. $2,200

d. $3,200

ANSWER: c

66. Ernest received the following distributions from Virginiana Mutual Fund for the calendar year 2022:

Ordinary dividends	$320

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Capital gain distributions	145
Nontaxable distributions	95

Emma, Ernest's wife, did not own any of the Virginiana Mutual Fund shares, but she did receive $1,475 in interest on a savings account at the Moss National Bank and $175 in interest on California municipal bonds. Ernest and Emma filed a joint income tax return for 2022. What amount is reportable as taxable *interest* income?

a. $0

b. $175

c. $1,475

d. $1,650

ANSWER: c

67. Destiny received the following distributions from Greener Mutual Fund for the calendar year 2022:

Ordinary dividends (nonqualifying)	$250
Capital gain distributions	170
Nontaxable distributions	80

Garrison, Destiny's husband, did not own any of the Greener Mutual Fund shares, but he did receive $1,600 in interest on a savings account at the Grassley National Bank. Garrison and Destiny filed a joint income tax return for 2022. What portion of the distributions from Greener Mutual Fund is taxable as *ordinary* income on their 2022 individual income tax return?

a. $0

b. $250

c. $420

d. $500

ANSWER: b

68. Tao, a single taxpayer, receives $500 of qualified dividends from ExxonMobil in the current year. His taxable income before the dividends is $26,000. Tao’s tax on the dividends will be _____.

a. $0

b. $25

c. $75

d. $100

ANSWER: a

69. An investor is comparing the following two bonds: a bond from ABC Corp which pays an interest rate of 9 percent per year and a municipal bond which pays an interest rate of 7.9 percent per year. The investor is in the 22 percent tax bracket. Which bond will give the investor a higher *after-tax* interest rate and for which reason?

a. The ABC bond because it pays a 9 percent interest rate, while the municipal bond only pays 7.9 percent.

b. The ABC bond because it pays an equivalent after-tax rate of 11.5 percent, while the municipal bond pays out an equivalent after-tax rate of 10.1 percent.

c. The municipal bond because it pays an equivalent after-tax rate of 7.9 percent, while the ABC bond pays out an after-tax 7.02 percent interest rate.

d. The municipal bond because it pays an equivalent after-tax rate of 7.9 percent, while the ABC bond pays out an equivalent after-tax rate of 2.0 percent.

ANSWER: c

70. Which taxpayer would benefit the most from a tax-free municipal bond compared to a taxable bond?

a. A taxpayer whose only income is from Social Security
b. A taxpayer who won a mega-million-dollar lottery
c. The average low-income worker
d. All taxpayers equally benefit from the tax-free municipal bond.

ANSWER: b

71. Nicole is a student at USB Law School where she receives a $52,000 scholarship. Of the $52,000, $40,000 is used for tuition, $5,000 is used for books, and $7,000 is used for room and board. How much of the scholarship is excluded from taxable income for Nicole?

a. $5,000
b. $7,000
c. $45,000
d. $47,000

ANSWER: c

72. To pay for college, Harry received the following:
$1,000 scholarship from the Thespian Club to pay for books
$4,000 scholarship from the Elks Lodge for tuition
$5,000 worth of room and board as a dorm supervisor through a work-study program

How much income must Harry report on his tax return?

a. $0
b. $4,000
c. $5,000
d. $6,000

ANSWER: c

73. Ivy and Taio were granted a divorce in 2016. In accordance with the decree, Taio made the following payments to Ivy in 2022:

Child support payments contingent on the age of the child	$6,000
Indefinite periodic payments terminating on Ivy's death	4,000

How much of the payments can Taio deduct as alimony in 2022?

a. $0
b. $6,000
c. $10,000
d. $4,000

ANSWER: d

74. Daniel and Celia were divorced under an agreement executed on February 15, 2022. According to the agreement, Daniel must transfer his interest in a rental house, worth $250,000, to Celia. His tax basis in the house is $80,000. What is the amount of the gain that Daniel must recognize on the property transfer? After the transfer, what is Celia's tax basis in the property?

a. $170,000 and $250,000
b. $0 and $250,000
c. $170,000 and $170,000

d. $0 and $80,000

ANSWER: d

75. Ren and Mina are divorced and under the terms of their written divorce agreement signed on December 30, 2016, Ren was required to pay Mina $1,500 per month of which $600 was designated as child support. He made 12 such payments in 2022. Additionally, Ren voluntarily paid Mina $1,200 per month for 12 months of 2022, no portion of which was designated as child support. Assuming that Mina has no other income, her tax return for 2022 should show gross income of _____.

a. $0

b. $7,200

c. $10,800

d. $18,000

ANSWER: c

76. Russell and Madalyn were divorced in 2014. Madalyn pays Russell alimony of $1,200 a month. The payment amount was agreed upon in the decree of divorce. To save money, Russell and Madalyn still live together. Are the alimony payments that Russell receives in 2022 included in his income?

a. Yes, the payments meet all alimony payment requirements.

b. Yes, alimony is always taxable.

c. No, only some of it is tax-exempt because Madalyn pays Russell too much alimony.

d. No, since Russell and Madalyn still live together, the payments are not considered alimony.

ANSWER: d

77. Zaid is required under a 2014 divorce decree to pay $500 of alimony and $200 of child support per month for 12 years. In addition, Zaid makes an additional voluntary payment of $100 per month. How much of the total monthly payment amount is deductible by Zaid?

a. $0

b. $200

c. $500

d. $600

ANSWER: c

78. Brianna and Anthony were granted a divorce in 2021. In accordance with the divorce decree, Anthony made the following payments to Brianna in 2022:

Child support payments contingent on the age of the child	$4,000
Annual cash payments, other than child support, specified as alimony in the divorce agreement	6,000

How much should Brianna include in her 2022 taxable income as alimony?

a. $0

b. $4,000

c. $6,000

d. $10,000

ANSWER: a

79. For divorce decrees entered before 2019, which of the following statements about deductible alimony payments is correct?

a. The payments must be in the form of cash, goods, or services.

b. Divorced or legally separated parties can be members of the same household at the time the payments are made.

c. The payment can be made directly to the creditors of the former spouse.

d. The payments must not be designated in the written agreement as anything other than alimony.

ANSWER: d

80. Kacey took an $8,000 distribution from their educational savings account and used $6,000 to pay for qualified higher education expenses. The remaining balance of $2,000 was used to purchase clothes. On the date of the distribution, their educational savings account had a $25,000 balance including the $20,000 they had contributed. How much of the $8,000 distribution is tax-free?

a. $0

b. $6,000

c. $7,600

d. $8,000

ANSWER: c

81. Charlie is a single taxpayer with income of $107,000 which includes $22,500 of interest income. Contributions to Coverdell educational savings accounts are phased out between $95,000 and $110,000. What is the maximum contribution Charlie can make to an educational savings account?

a. $400

b. $1,600

c. $2,000

d. $2,500

ANSWER: a

82. Which of the following is correct for Qualified Tuition Programs?

a. Contributions are deductible and qualified educational expense distributions are tax-free.

b. Contributions are not deductible and qualified educational expense distributions are tax-free.

c. Contributions are deductible and qualified educational expense distributions are taxable.

d. Contributions are not deductible and qualified educational expense distributions are taxable.

ANSWER: b

83. Which of the following is *true* with respect to an education incentive?

a. Contributions to Qualified Tuition Programs (Section 529 plans) are deductible.

b. Contributions to education savings accounts (Coverdell ESAs) are deductible.

c. Tuition paid by a taxpayer earning $300,000 of income is deductible.

d. Married taxpayers at any income level may contribute to a Qualified Tuition Program (Section 529 plan).

ANSWER: d

84. For married taxpayers filing a joint return in 2022, at what AGI level does the phase-out limit for contributions to Qualified Tuition Programs (Section 529 plans) start?

a. $190,500

b. $220,000

c. $400,000

d. There is no phase-out limit on Qualified Tuition Program contributions.

ANSWER: d

85. In 2022, Stefan worked as a tech supervisor for a computer company, where he earned $4,500 a month. In September of 2022, he was laid off. He was paid unemployment compensation for the rest of the year totaling $7,000. Which of the following is *true*?

a. Stefan will have to report all $7,000 of the unemployment compensation as income.

b. Stefan will have to report $6,500 of the unemployment compensation as income.

c. Unemployment compensation is never taxable.

d. Since the unemployment compensation payments are less than his previous salary, they are not taxable.

ANSWER: a

86. Fatima received unemployment benefits in 2022. Which of the following is *true*?

a. All of the unemployment benefits are taxable.

b. All of the unemployment benefits are nontaxable.

c. Half of the unemployment benefits are taxable and half are nontaxable.

d. The taxability of the unemployment benefits depends upon other income received for the year.

ANSWER: a

87. Which of the following is *true* regarding Social Security benefits?

a. The Social Security inclusion formula is the same amount for each filing status.

b. Social Security benefits are always excluded because wages are subject to Social Security tax when earned.

c. Tax-exempt interest income must be included in the formula used to determine if Social Security is included in taxable income.

d. Up to 100 percent of Social Security benefits received may be included in taxable income.

ANSWER: c

88. For the current year, the maximum percentage of Social Security benefits that might be included in a taxpayer's gross income is _____.

a. 50 percent

b. 65 percent

c. 85 percent

d. 100 percent

ANSWER: c

89. Roxanne and Zach are married and live in Texas. Roxanne earns a salary of $50,000, and Zach owns a rental property that gives him $35,000 of income. If they filed separate tax returns, what amount of income would Zach report?

a. $35,000

b. $85,000

c. $42,500

d. $60,000

ANSWER: c

90. Which one of the following conditions must be satisfied in order for a married taxpayer to be taxed on only their own income if they reside in a community property state?

a. The husband and wife must live apart for the entire year.
b. The husband and wife must live apart for more than half the year.
c. The husband and wife must be in the process of filing for a divorce.
d. Only one of the spouses can be working and earning an income.

ANSWER: a

91. Which of the following is a *true* statement regarding community property law?
a. For a married couple living in Wisconsin, income derived from separate property is taxable to the owner of the property.
b. For a married couple living in California, income derived from separate property produces community income.
c. In all community property states, the salary of married spouses is allocated one-half to each spouse.
d. Property acquired before marriage in a community property state becomes community property unless specifically opted out.

ANSWER: c

92. Lee and Pat are married taxpayers living in Louisiana. Lee earns wages of $40,000 and has $5,000 of dividend income from separate property. Lee and Pat have interest income from community property of $10,000. If Lee and Pat file separate income tax returns, what amount of income must be included on Lee's separate tax return?
a. $50,000
b. $30,000
c. $27,500
d. $25,000

ANSWER: c

Objective Short Answer

93. Diego, a single taxpayer, received the following items in 2022: dividends of $450, wages of $32,000, child support from his ex-spouse of $400 per month, a new television worth $1,200 from a door prize at a conference he attended, a gift of $3,000 from Diego’s parents, and $200 of interest on bonds issued by the State of Arizona. Diego put $5,000 of his wages into his employer's dependent care flexible spending account (the $5,000 has not been deducted from the $32,000 of wages listed previously). He also receives a reimbursement of $270 per month to pay for public transportation passes each month (the monthly reimbursement of $270 has not been deducted from the $32,000 of wages). Based on the above, what is Diego’s gross income in 2022?

ANSWER: $25,410

Item	Amount	Explanation
Dividends	$450	Included
Wages	$32,000	Included
Child support	$0	Excluded
Door prize	$1,200	Included
Gift	$0	Excluded
Municipal bond interest	$0	Excluded
Child care	($5,000)	Excluded up to $5,000
Public transportation	($3,240)	Excluded up to $280 per month
Gross income	$25,410	

Subjective Short Answer

94. Andy landscaped his friend’s yard in return for a couch set and an HD television worth $8,000. How much income must Andy report on his tax return for his services?

ANSWER: The noncash payment of $8,000 for services performed is taxable income to Andy. The tax law states that taxable income is “all income from whatever source derived.” There is no exception in the law for noncash items received in exchange for services.

95. Jake is a lawyer, and Georgia is a child psychologist. Jake prepares Georgia’s estate planning at no charge and Georgia agrees to counsel Jake’s daughter six times at no charge in return for the estate planning. The value of the estate planning is $1,000, and the value of the therapy sessions is $1,000.

a. How much income does Jake have? Why?
b. How much income does Georgia have? Why?

ANSWER: a. **$1,000**. Taxable income includes “all income from whatever source derived.” The value of the therapy for his child is income to him for the performances of services. There is no taxable income exception in the tax law for “barter income.”
b. **$1,000**. Taxable income includes “all income from whatever source derived.” The value of the estate planning is income to her for the performances of services. There is no taxable income exception in the tax law for “barter income.”

96. Brady has a successful online gambling enterprise that is illegal under federal law. Is Brady required by law to report the income from his online gambling business on his tax return? Why?

ANSWER: Yes. Illegal income is still taxable income since there is no exception excluding it in the tax code. Unless there is an explicit exclusion in the tax law, taxable income is “all income from whatever source derived.”

97. In 2022, Bonnie receives salary income of $32,000, unemployment compensation of $7,000, and interest income of $1,200 and a gift of $4,400 in cash from her aunt. How much gross income does Bonnie have?

ANSWER: **$40,200**. ($32,000 + $1,200 + $7,000)

98. Indicate whether each item below would be included in or excluded from the income of the recipient.

a. Payment for laboratory assistant position at University of California State
b. A $1,000 scholarship for tuition
c. College books paid for by grandma and grandpa
d. A $1,000 college loan
e. A scholarship for room and board
f. A new car given to recruit a professional basketball player
g. A scholarship used for supplies and equipment that are required for courses

ANSWER: a. Included
b. Excluded
c. Excluded
d. Excluded
e. Included
f. Included
g. Excluded

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CH 02 Gross Income and Exclusions

99. Joseph is a single taxpayer. Joseph's employer pays $1,800 per year for his health insurance. During the year, Joseph had medical expenses of $2,500, and the insurance company reimbursed him for the full $2,500. How much of the above amounts, if any, must be included in Joseph's gross income? Why?

ANSWER: **None.** Neither the health insurance premiums paid by the employer nor the reimbursement of medical expense by the insurance company is considered income to Joseph.

100. Marco and his family are covered by his company's health insurance plan. The health insurance costs his company $8,500 a year. During the year, Marco's daughter is diagnosed with a serious illness, and the health insurance pays $25,000 for treatment. How much of the insurance and treatment costs are taxable to Marco?

ANSWER: **None.** The cost of the family insurance as well as amounts paid by the insurance company for treatment are not taxable to Marco. These amounts are specifically excluded from taxable income under the tax law.

101. State whether each of the following is taxable or nontaxable.

a. Sofia won a jackpot of $50,000 gambling at a casino.
b. Sarah received a Thanksgiving turkey from her employer.
c. Jonathan won a car in a supermarket raffle valued at $25,000.
d. Jamir received a scholarship for tuition of $5,000.
e. Eric is given lodging valued at $1,000 a month on the oil rig where he is employed since it is impossible for Eric to go home during the period of time he is assigned to work on the rig.

ANSWER: a. Taxable
b. Nontaxable
c. Taxable
d. Nontaxable
e. Nontaxable

102. Diana is a machinist in a remote Alaskan crab-freezing plant. The plant is accessible only by boat or airplane, and there is no available lodging for rent. Diana's employer provides her with lodging at the plant and pays for all of her electricity, gas, and other utilities, valued at $700 per month. Is the value of the lodging taxable to Diana? Explain.

ANSWER: **No**. The lodging costs paid by the employer are not taxable to the employee because the lodging is on the business premises and must be accepted as a requirement for employment.

103. As a new benefit to employees, Acme Company is providing a dining allowance every Tuesday for use in one of the 20 restaurants that it owns around town. Should this benefit be included in the wages of the employees?

ANSWER: Yes. The meals are not being provided for the convenience of the employer. Therefore, the value of the meals should be included in the wages of the employees.

104. Trevon, a single taxpayer, works for the men's clothing division of a large corporation. During the year, Trevon received the following fringe benefits:

	Value
20 percent discount on men's clothing (the usual markup is 40 percent)	$350
15 percent discount on toys from the toy division of the company (the usual markup is 25 percent)	100
Personal copies on the company's copier	15
A subscription to *Men's Clothing Weekly*	35
Use of the company's athletic facilities	50

As a result of receiving the above fringe benefits, what amount must Trevon include in his current year gross income?

ANSWER: **$100**, the discount on toys from the toy division.

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CH 02 Gross Income and Exclusions

105. Omar's tax client, Tiana, is employed at a large company that offers health care flexible spending accounts to its employees. Tiana must decide at the beginning of the year whether she wants to put as much as $2,750 of her salary into the medical flexible spending account. Tiana has excellent insurance through the company and is very healthy. She does not expect to have any medical expenses during the year. Tiana does not normally itemize deductions on her tax return. Should Omar recommend that Tiana allocate the maximum to her health care flexible spending account? Why or why not?

ANSWER: No. Tiana will be better off keeping her salary $2,750 higher and paying tax on the salary, since she will likely have no medical costs to reimburse from a health care spending account during the year. If Tiana has no medical expenses, she could lose all or part of the $2,750 in the account after the end of the year.

106. Rob is 8 years old and won a sports car valued at $30,000 in a drawing at Disneyland this year while he was vacationing with his parents. How much income, if any, must Rob report on his tax return for this year? Why?

ANSWER: **$30,000**. Prizes are taxable income, valued at fair market value regardless of the age of the recipient.

107. Makena retired in May 2022. Her pension is $1,000 per month from a qualified retirement plan to which she contributed $42,000, and to which her employer contributed $12,000. Makena was 67 when the plan payments started. During 2022, she received 8 months of payment for a total of $8,000 from the plan.

a. Using the simplified method, calculate Makena's taxable income for 2022 from the retirement plan distributions.
b. If Makena's contributions to the plan had been $25,200, instead of $42,000, using the simplified method, how much taxable income would she have to report in 2022 from the plan distributions?

ANSWER: a. **$6,400**. $42,000 ÷ 210 (factor for age 67) = $200 × 8 months = $1,600. $8,000 − $1,600 = $6,400

b. **$7,040**. $25,200 ÷ 210 = $120 × 8 months = $960. $8,000 − $960 = $7,040

108. Cynthia, age 64, retired in June. Starting in July, Cynthia received $2,000 per month from an annuity. She has contributed $260,000 to the annuity. How much is excluded from income using the simplified method?

ANSWER: $6,000 is excluded from income.

Simplified method calculation:
1. Enter total amount received this year: $12,000
2. Enter cost in plan at the annuity starting date: $260,000
3. Factor at annuity starting date: 260
4. Divide line 2 by line 3: $1,000
5. Multiply line 4 by the number of monthly payments this year: $6,000
6. Amount, if any, recovered tax free in prior years: $0
7. Subtract line 6 from line 2: $260,000
8. Enter the smaller of line 5 or 7: $6,000
9. Taxable amount this year. Subtract line 8 from line 1: $6,000

109. Tobie transfers to Keith a life insurance policy with a face value of $25,000 and a cash value of $5,000 in payment of a personal debt. Keith continues to make premium payments on the policy until Tobie's death. At that time, Keith had paid $1,500 in premiums.

a. How much income must Keith report when he receives the $25,000 in proceeds?
b. Would your answer be different if Tobie and Keith were partners in a partnership? Why?

ANSWER: a. **$18,500**. ($25,000 − $5,000 − $1,500).

b. **Yes**. Transfers to a partner, even for valuable consideration, result in nontaxable proceeds.

110. Amaia transfers to Arjun a life insurance policy with a face value of $40,000 and a cash value of $8,000 in payment of a personal debt. Arjun continues to make premium payments on the policy until Amaia's death. At that time, Arjun had paid $3,500 in premiums.

a. How much income must Arjun report when he receives the $40,000 in proceeds?
b. Would your answer be different if Amaia were a shareholder and CEO of a corporation to which the policy was transferred? Why?

ANSWER: a. **$28,500**. ($40,000 − $8,000 − $3,500)
b. **Yes**. Transfers to a corporation by a shareholder and officer of a corporation, even if for valuable consideration, result in nontaxable proceeds.

111. Jovan is sick and tired of his job. His doctor certifies that his health may be compromised if he continues to work at his current place of employment. He sells his life insurance policy to Life Settlements, Inc. for $50,000 so he can take a break from work. He has paid $10,000 so far for the policy. How much of the $50,000 must Jovan include in his taxable income?

ANSWER: He must pay tax on the $40,000 gain on the sale of the policy. Jovan has not met the requirement for an accelerated death benefit or a viatical settlement.

112. Helga receives a $300,000 life insurance payment when her boyfriend Cody dies. How much of the payment is taxable to Helga?

ANSWER: None of the payment is taxable. Life insurance proceeds received upon the death of the insured are generally considered to be tax-free and specifically excluded from taxable income.

113. Qualified dividends are given special tax treatment. Describe how they are taxed in 2022.

ANSWER: Qualified dividends are taxed at 0, 15, or 20 percent depending on the taxpayer's filing status. The 0 percent rate applies to taxpayers with incomes below a certain threshold ($41,675 for single or married filing separately, $55,800 for head of household, and $83,350 for married filing jointly). The 15 percent rate applies to taxpayers with income in excess of those amounts up to the 20 percent thresholds of $459,751 (single), $258,601 (married filing separately), $517,201 (married filing jointly), and $488,501 (head of household). An additional 3.8 percent Medicare tax may apply for high-income taxpayers.

114. If a taxpayer holding EE bonds makes an election with respect to the taxation of the bonds, how is the interest which accrues on the bonds, but is not paid, taxed each year?

ANSWER: If an election is made, the annual increase in the redemption value of the bond (or interest accrual as it is commonly called) is included in taxable income each year.

115. In 2022, what rate would a single taxpayer pay on qualified dividend income in each of these cases?

a. If in the 37 percent bracket?
b. If in the 24 percent bracket?

ANSWER: a. **20 percent**
b. **15 percent**

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CH 02 Gross Income and Exclusions

116. A taxpayer in the 33 percent tax bracket invests in a New York City bond paying 5 percent interest. What taxable interest rate would provide the same after-tax return?

ANSWER: **7.46%**. [5% ÷ (1 − 0.33)]

117. Miranda is a wealthy widow who has come to you for tax advice. She is in the 35 percent tax bracket. She has a choice between investing in a high-quality municipal bond paying 3.5 percent or a high-quality corporate bond paying 7 percent. From a tax standpoint, which investment would you advise her to make and why?

ANSWER: She should invest in the corporate bond. At the 35 percent tax bracket, the after-tax equivalent rate on the corporate bond is 4.55 percent or 7 percent times (1 − 0.35), which is greater than the 3.5 percent rate of return on the municipal bond.

118. A taxpayer in the 32 percent tax bracket invests in a City of San Diego bond paying 8 percent interest. What taxable interest rate would provide the same after-tax return?

ANSWER: **11.76%**. [8% ÷ (1 − 0.32)]

119. In June of the current year, Riley's stepmother died and left them a stock portfolio worth $600,000. Before she died, she gave them a gift of $20,000 in cash. How much of these amounts, if any, are taxable to Riley? Why?

ANSWER: $0

Inheritances and gifts are not taxable to the recipient.

120. In June of the current year, an aunt gave Myah a stock portfolio worth $150,000. During the year, she collects $4,000 in dividends from this portfolio. How much of these amounts, if any, should Myah include in gross income for the current year? Why?

ANSWER: **$4,000**. The gift of stock is not classified as income, but earnings on the stock are income.

121. Jayden is a company president who has had a very good year at work. The owner of the company is pleased and gives him a gift of $50,000 at the end of the year. The owner writes "gift" in the memo section of the check. How much of the gift is taxable to Jayden?

ANSWER: The full $50,000 is taxable. The gift is clearly bonus income in a business setting, and as such it does not qualify for tax-free gift treatment, even if Jayden's employer calls the payment a gift.

122. Morgan receives a $25,000 gift from their parents for a down payment on a house. Their parents write "gift" in the memo line of the check. How much of the gift is taxable to Morgan?

ANSWER: None of the gift is taxable. Gifts are excluded from the taxable income of the person receiving the gift.

123. Zion receives a rental property as an inheritance from his grandmother. The rental property is worth $500,000, and Zion collected rental income of $24,000 during the year.

For the year, how much is Zion's gross income as a result of the inheritance?

ANSWER: **$24,000**. **(**the amount of the rental income)

124. Karina receives a scholarship of $10,000 to a college. She is also given a job which pays $5,000 a year to help with her expenses. $7,000 of the scholarship is earmarked for tuition and $3,000 is for room and board. How much of the money from the scholarship and the job are taxable to Karina?

ANSWER: **$8,000**. The $5,000 earnings from the job are taxable, as is $3,000 of the scholarship earmarked for room and board (scholarship amounts received for room and board are taxable to the recipient). $7,000 is not taxable since scholarships for tuition are specifically excluded from taxable income.

125. In 2022, Kaliah earned $30,000 from JDR Co. before she was laid off. She then collected $7,000 of unemployment

benefits. Finally, Kaliah received a $12,500 scholarship for tuition so she could return to college to earn a microbiology degree. How much does Kaliah need to report as income on her 2022 tax return?

ANSWER: **$37,000**. ($30,000 from her employment at JDR Co. and $7,000 from unemployment benefits received. The $12,500 scholarship is excluded from income.)

126. Under a divorce agreement executed in 2015, Bo is required to pay his ex-wife, Cadence, $3,000 a month until their youngest daughter is 21 years of age. At that time, the required payments are reduced to $2,000 per month.

a. How much of each $3,000 payment may be deducted as alimony by Bo?
b. How much of each $3,000 payment must be included in Cadence's taxable income?

ANSWER: a. **$2,000**
b. **$2,000**

The amount over the continuing alimony payment is not treated as alimony for tax purposes.

127. Under the terms of a property settlement executed during the current year, Cindy transferred a house worth $375,000 to her ex-husband, Cameron. The property has a tax basis to Cindy of $310,000.

a. How much taxable gain or loss must be recognized by Cindy at the time of the transfer?
b. What is Cameron's tax basis in the property he received from Cindy?

ANSWER: a. **$0**
b. **$375,000**

128. Isaiah is required by his 2022 divorce agreement to pay alimony of $4,000 a month and child support of $6,000 a month to his ex-wife India. What is the tax treatment of these two payments?
To Isaiah?
To India?

ANSWER: Under tax law for a post-2018 divorce:
Isaiah cannot deduct the alimony or the child support.
India will not report the alimony or the child support as income.

129. As part of the property settlement related to their 2022 divorce, Heather must give Javaris the house that they have been living in, while she gets 100 percent of their savings accounts. The house was purchased in Texas 15 years ago for $100,000 and is now worth $110,000. How much gain must Heather recognize on the transfer of the house to Javaris? What is Javaris's tax basis in the house for calculating any future sale of the house?

ANSWER: No gain is taxable to Heather on the transfer of the house since it is part of a property settlement related to a divorce. Javaris has a basis of $100,000 in the house for calculating tax on any future sale of the house.

130. Geoffrey receives $20,000 from a qualified tuition program created by his grandmother. The program had accumulated $6,000 in earnings. He used the full $20,000 to pay for qualified higher education expenses. Calculate the amount of earnings subject to taxation.

ANSWER: **$0**. Both the original contributions and the earnings were used to pay for qualified higher education expenses.

CH 02 Gross Income and Exclusions

131. Justin, a single parent, would like to contribute $1,800 to an educational savings account for his 10-year-old son. Justin's AGI is $98,000. Calculate the amount of the contribution he can make.

ANSWER: **$1,600**. His contribution is limited because of his AGI. ($110,000 − $98,000) ÷ $15,000 × $2,000 is $1,600. $15,000 is the range between the upper and lower phase-out limits.

132. Melinda took a $1,500 distribution from her educational savings account and used $1,200 to pay for qualified education expenses. Before the distribution, Melinda's account balance was $4,000, of which $1,000 was earnings. Calculate the following:

a. The tax-free return of capital
b. Her new adjusted basis for her savings account
c. Distribution of earnings *potentially* subject to tax
d. The excludable portion of the earnings
e. The taxable portion of her earnings

ANSWER: a. **$1,125**. 75 percent of the account balance before the distribution was from Melinda's contributions; therefore, 75 percent of the amount distributed is a return of her capital.
b. **$1,875**. $3,000 basis before distribution less tax-free return of capital of $1,125.
c. **$375**. The total distribution of $1,500 less the $1,125 return of capital.
d. **$300**. The potential amount subject to tax, $375, times the ratio of the amount used to pay for qualified education expenses, $1,200, to the full distribution, $1,500, equals the excludable portion.
e. **$75**. The potential amount subject to tax, $375, times the ratio of the amount not used to pay for qualified education expenses, $300, to the full distribution, $1,500, equals the taxable portion.

133. Xavier, a single individual, was unemployed for a few months during 2022. During 2022, he received $3,600 in unemployment compensation payments. How much of his unemployment compensation payments must be included in gross income?

ANSWER: **$3,600**. Unemployment compensation payments are generally fully taxable and included in gross income.

134. Answer the following questions regarding the taxability of Social Security payments.
a. Will a taxpayer with no income other than Social Security have to include the Social Security in taxable income?
b. Will a taxpayer with a large amount of municipal bond income, but no taxable income, likely have to pay tax on part of their Social Security?
c. What is the maximum percentage of Social Security benefits that may be subject to tax on an individual's tax return?

ANSWER: a. **No**. The taxpayer's income is below the threshold amount used in the formula to determine whether Social Security is taxable.
b. **Yes**. Tax-free municipal bond income is added to AGI in the formula to determine the amount of taxable Social Security.
c. **85%**. High-income taxpayers must include 85 percent of Social Security receipts in taxable income.

135. During the tax year, Thomas and Yolanda received $24,000 in Social Security benefits. The amount of their adjusted gross income for the year was $2,000, and they received no tax-exempt interest income.

Calculate the amount of the Social Security benefits that Thomas and Yolanda must include in their gross income for the year.

ANSWER: **$0**. Their modified adjusted gross income is less than the base amount required to have taxable Social Security.

136. Anja and Clinton are married but file separate tax returns. Anja received a salary of $42,000. Clinton is unemployed but received $15,000 of dividends from a stock portfolio that is his own separate property.

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CH 02 Gross Income and Exclusions

a. If Anja and Clinton live in a common law state, what income should Anja show on her separate return?
Salary
Dividends

b. If they live in California (a community property state), what income should Anja show on her separate return?
Salary
Dividends

ANSWER: a. Salary: **$42,000**
Dividends: **$0**
b. Salary: **$21,000**
Dividends: **$0**

137. Rachel and Noah are married and living together. Their income is:

Noah's salary	$120,000
Rachel's net income from her business	130,000
Interest (Noah's separate property investments)	4,000
Interest (Rachel's separate property investments)	2,000
Dividends (community property)	5,000

Total income is $261,000.
a. If they live in Arizona and Rachel files a separate return, how much income should she report?
b. If Noah and Rachel live in Wisconsin and file separately, what should Rachel report as income?

ANSWER: a. **$129,500**. 50% of Noah's salary, $60,000, plus 50% of Rachel's net business income, $65,000, plus 100% of Rachel's interest income on her property, $2,000, plus 50% of the dividends on community property, $2,500, for a total of $129,500.
b. **$130,500**. 50% of Noah's salary, $60,000, plus 50% of Rachel's net business income, $65,000, plus 50% of Rachel's interest income on her property, $1,000, plus 50% of Noah's interest income on his property, $2,000, plus 50% of the dividends on community property, $2,500, for a total of $130,500.

138. Indicate whether each of the items listed below would be (a) included in gross income or (b) excluded from gross income for the 2022 tax year.
a. Receipt of alimony in 2022 from a 2019 divorce
b. Lottery winnings
c. Life insurance proceeds received upon the death of a family member
d. Child support payments
e. Reimbursement of hospital expenses from a health insurance plan
f. Municipal bond interest
g. Unemployment compensation
h. Scholarships for tuition and books
i. Wages
j. Farm income
k. Inheritances

ANSWER: a. Excluded
b. Included
c. Excluded
d. Excluded

e. Excluded
f. Excluded
g. Included
h. Excluded
i. Included
j. Included
k. Excluded

139. Indicate whether each of the following is included in or excluded from gross income.

a. Payment for the loss of an arm
b. Premiums for health insurance paid by the employer
c. Reimbursement from the insurance company for a physical examination

ANSWER: a. Excluded
b. Excluded
c. Excluded

Essay

140. Ordinarily, life insurance proceeds are excluded from gross income. Why would they be taxable if the policy had been transferred for valuable consideration, prior to the death of the insured?

ANSWER: If a policy is transferred for valuable consideration, it takes on the nature of an investment for the new owner. Generally, the excess of the amount realized on disposal of an investment over the cost of the investment is subject to taxation.

141. During the current year, Margaret and John received $24,000 in Social Security benefits. The amount of their adjusted gross income for the year before any Social Security income was $140,000, and they received $19,000 in tax-exempt income.

Explain the treatment of their Social Security income for tax purposes and the likely percentage of the Social Security income that will be taxable to Margaret and John.

ANSWER: Social Security income is partially taxed based on the taxpayer's modified adjusted gross income. Modified adjusted gross income includes adjusted gross income plus tax-exempt interest plus half of the Social Security received. For low-income taxpayers, no Social Security income is taxable. Higher-income taxpayers must include 50 to 85 percent of the Social Security receipts in income. Given the high level of income reported by Margaret and John, it is safe to say they would have to include 85 percent of the Social Security payments in taxable income. To be certain, the IRS Social Security worksheet should be used to calculate the taxable amount.